

TAX MATTERS

A newsletter dedicated to informing California Aircraft and Vessel owners about taxes

Prepared and distributed by Aero & Marine Tax Professionals

Section 6596 — Get it in Writing or Pay the Price.

There is an organizational axiom that states, "If it is not in writing, it isn't true." If an organization wants to hold another person liable for the expert advice they offer, the company receiving that advice would receive their instructions in writing.

Only a naive person would attempt to win in court by using hearsay evidence. The rules of evidence require hard proof that a communication took place. Basically, the rules reaffirm the axiom when they require physical proof of an important communication.

Yet every day otherwise very savvy business owners will rely on verbal advice when it comes to receiving information from a government employee. Million dollar corporations regularly make important accounting decisions based on verbal instructions received over the telephone from the California State Board of Equalization (Board). In their quest to do the right thing, companies often call the local branch of the California agency that is responsible for administering the sales and use tax laws and act on verbal data they receive.

When these same companies receive additional tax assessments for following the advice given to them by the Board, they inevitably use those instructions by a Board employee as their defense. In the absence of other mitigating circumstances, this defense will always be refuted. The section of law that does grant relief for instruction is Section 6596, which states in pertinent part:

6596. Excusable delay-reliance on advice. (a) If the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of the taxes imposed by Sections 6051 and 6201 and any penalty or interest added there to.

This seems simple, but if you read this section one word at a time you will immediately see some of the pitfalls. First, the body that gets to decide is the Board, not the taxpayer. The phrase "reasonable reliance," opens the circumstances up to subjective interpretation. This section only says you "may" be relieved, it doesn't make it a sure thing.

The rest of Section 6596 begins to sharpen the focus of exactly what a taxpayer must do to claim relief under this section.

- (b) For the purpose of this section, a person's failure to make a timely return or payment shall be considered to be due to reasonable reliance on written advice from the Board, only if the Board finds that all of the following conditions are satisfied:"
- (1) The person requested in writing that the Board advise him or her whether a particular activity or transaction is subject to tax under this part. The specific facts and circumstances of the activity or transaction shall be fully described in the request.
 - (2) The Board responded in writing to the person regarding the written request for advice, stating whether or not the described activity or transaction is subject to tax, or stating conditions under which the activity or transaction is subject to tax.

- (3) In reasonable reliance on the Board's written advice, the person did not do either of the following:
- (A) Charge or collect from his or her customers amounts designated as sales tax reimbursement or use tax for the described activity or transaction.
 - (B) Pay a use tax on the storage, use, or other consumption in this state of tangible personal property.
- (4) The liability for taxes applied to a particular activity or transaction which occurred before either of the following:
- (A) Before the Board rescinded or modified the advice so given, by sending written notice to the person of the rescinded or modified advice.
 - (B) Before a change in statutory or constitutional law, a change in the Board's regulations, or a final decision of a court, which renders the board's earlier written advice no longer valid.
- (c) Any person seeking relief under this section shall file with the Board:
- (1) A copy of the person's written request to the Board and a copy of the Board's written advice.
 - (2) A statement under penalty of perjury setting forth the facts on which the claim for relief is based.
 - (3) Any other information which the Board may require.
- (d) Only the person making the written request shall be entitled to rely on the Board's written advice to that person.

The following examples represent some typical appeals:

Case #1

Petitioner entered into a contract to fabricate and install storage tanks at a California location for a lump sum price. He took a resale certificate from his customer and did not charge or pay sales tax on the transaction.

The auditor regarded the contract as a construction contract and asserted tax based on the cost to petitioner of materials used to fabricate the tanks. The auditor did not accept the resale certificate because he regarded petitioner as the consumer of the materials.

The petitioner stated that he was instructed by a Board employee over the telephone to obtain a resale certificate.

The petition was denied.

Subdivision (b) (6) of Regulation 1521 provides that a contractor cannot avoid liability for tax on materials or fixtures furnished and installed by him by taking a resale certificate. The reason is that the sale occurs after the property has changed from personal property to real property by virtue of its installation.

Section 6596 provides that the Board may grant relief from a failure to pay if the failure resulted from reliance upon written advice from a Board employee which is in response to a written request for advice. The petition further alleged that he received erroneous advice. The decision in the *Fischbach & Moore, Inc. v. State Board of Equalization* (1981) 117 Cal. App. 3d 627 held that erroneous advice from an employee of the Board cannot create an exemption which is not authorized by law.

Case #2

The taxpayer contended that he should not be held liable for tax because he received information during a previous audit that indicated tax would not be due on transaction similar to those at issue in his new audit.

The petition was denied.

The Board held that the circumstances in the new audit were sufficiently different from the previous audit and that the transactions were substantially different. However, in the analysis of the case a rather revealing statement is made. A Revenue and Taxation Code section 6596 provides the only basis for relief from tax, penalty or interest based on the receipt of erroneous advice from the Board. The Board considers written evidence of erroneous advice that is contained in a prior audit report to constitute such written advice from the Board.

This decision clearly states that prior audits constitute written advice and that relying on erroneous advice in a previous audit does provide relief from the tax.

Case #3

During an audit in the late seventies the taxpayer obtained a letter from a field audit supervisor that confirmed he was told that the piece of equipment he sold was classified as machinery and equipment. In a subsequent review a different auditor cited another case that supported the Board's position and that type of equipment was in fact taxable. A revised audit was prepared. When the taxpayer filed a claim for refund citing 6596 the petition was denied.

The analysis stated that while the letter the taxpayer had received in the seventies did provide for relief under 6596, because the Board had officially changed its opinion on the matter six years later, the new opinion canceled the written proof the taxpayer had previously received.

The examples are provided for the readers to show the imperative nature of receiving written advice from the Board. It is mandatory. However, the examples also reveal that the information that flows from the Board can be inconsistent and in many cases conflicting. Because the Board is the ultimate judge (during the appeal) it is incumbent on the taxpayer to obtain written documentation in every case.

It is also important that taxpayers read the Tax Bulletin that is mailed out by the Board with each return. Any policy or position change by the Board that reverses previous written advice can be controverted by the mere inclusion of printing and mailing it in the Tax Bulletin. It has been held that this method of notifying taxpayers constitutes written advice of the change of position.

Regulation 1705 was officially adopted on July 31, 1997 and it seems to clear up some of the upheaval in the Board as to what constitutes proof and what should be accepted from that point forward. Two major victories for taxpayers under this new regulation are the automatic inclusion of prior audits and the clarifying statement that reads in pertinent part:

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction.

In spite of every attempt by the Board or taxpayers to reduce confusion, because of the complex nature of the laws and the sheer weight of training thousands of auditors to understand every facet of the law, a prudent taxpayer should always protect himself.

The axiom of getting all advice in writing must prevail.

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