STATE OF CALIFORNIA

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January 20, 2006

Mr. M--- M---
T--- R--- & P--- L---
Attorneys at Law
XXX --- Street, Suite XXXX
--- ---, CA XXXXX

Re: SR --- XX-XXXXXX
R--- G--- Company[1]
Sales of Private Selection Sparkling Cider Apple Juice

Dear Mr. M---:

Assistant Chief Counsel Janice L. Thurston has referred your letter to her dated February 18, 2005, to me for a response. You ask for a letter ruling on two issues: (1) whether sales made by your client, R---s G--- Company, of Private Selection Sparkling Cider Apple Juice (Sparkling Cider)[2] are subject to California sales tax; and (2) regardless of whether or not sales of Sparkling Cider are subject to tax, has your client fully complied with its obligations under California law by remitting to the Board all sales tax reimbursement it collected with respect to its sales of the Sparkling Cider. We note that Board staff cannot issue tax rulings; only the Board itself may do that. We can, however, give you our opinion regarding the correct application of tax to a given set of facts.

We understand that your client is currently a defendant in a class action lawsuit in Los Angeles County Superior Court under the Unfair Competition Law (UCL) regarding its collection of sales tax reimbursement on its sales of Sparkling Cider. You indicate in your letter

[1] The permit is actually issued in the name of H--- M---, Inc., dba R--- G--- Company.

[2] The copy of the label you attached to your letter called the product "Sparkling Cider" but also further described it as "Apple Juice from Concentrate." The following quote explains the difference: "In the grocery store today, 'apple juice,' 'apple cider,' and 'sweet cider,' all refer to the same product. When you buy any of these in the store, you are really buying pasteurized apple juice. This apple drink may be slightly cloudy because some of the pulp is still in it, or it may be treated so that it becomes clear and sparkling. [¶] At roadside stands, however apple juice and apple cider may be different. At roadside stands they often sell 'country cider' that may be produced in a farm mill setting. Country cider is a cloudy, unpasteurized form of apple juice that needs refrigeration. It may or may not be allowed to ferment to varying degrees." Cooperative Extension, *Your Holiday Baking Questions Answered – Part 2* (11/21/05) <http://www.seminolecountyfl.gov/lls/coopext/articles.asp?articleID=469> (as of 11/28/05).) Thus, we understand that "sparkling cider" and "sparkling apple juice," as sold in stores such as R---s, are basically the same product.

that the judge has continued the case in order for your client to obtain this opinion letter from the Board.

I. FACTUAL BACKGROUND.

As indicated by the quoted passages below, you describe the background of the controversy as follows:

A. 1993 SBE Audit of R---s.

> "R--- is a retailer engaged in the sale of grocery products in California. Prior to 1993, R--- did not charge its customers [sales tax reimbursement, or] STR, or remit sales tax to the SBE, with respect to sales of carbonated fruit juices. R--- believed carbonated fruit juices were tax-exempt based upon Revenue & Taxation Code section 6359(a)(3),[3] which generally characterizes 'fruit juices' as 'food products' [the sales of which] are exempt from California sale[s] tax if sold for human consumption.
>
> "In 1993, R--- was audited by Lane Yoshiyama of the SBE sales tax field office then located in Downey, CA. The audit covered the three-year period, which began with the Third Quarter of 1988 and ended with the Second Quarter of 1991. Mr. Yoshiyama examined all of the eight *carbonated* fruit juices then in R---' internal 'juice' category.[4] Mr. Yoshiyama concluded that, other than the Martinelli's sparkling apple juice (which he explained had been granted a special exemption), [sales of] all of the *carbonated* beverages were taxable. In support of this conclusion, Mr. Yoshiyama cited Annotation 245.0285 (3/5/87), which provides that *carbonated* beverages that contain *any additives* or preservatives are not considered to be natural fruit juices and therefore are *not exempt* 'food products.' Mr. Yoshiyama explained that the *carbon dioxide added* to the fruit juices offered for sale by R--- constituted an *additive* within the meaning of Annotation 245.0285. Consequently, R--- was required to remit (and did remit) sales tax to the SBE for those [sales of] *carbonated* fruit juices (other than the Martinelli's product) with significant item movement during the period under examination. In reliance on these audit findings by the SBE, R--- thereafter began charging its customers STR, and remitting sales tax, with respect to sales of all of its *carbonated* fruit beverages (other than the Martinelli's product) to which *carbon dioxide* had been *added*."

You did not furnish copies of the audit work papers, and the audit work papers remaining in the district office's file do not contain any auditor comments regarding specific products. As a result, we are unable to confirm your account of Mr. Yoshiyama's findings from Board records.

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[3] This citation is likely a typographical error. The actual cite is Revenue and Taxation Code section 6359(b)(3).

[4] These eight carbonated fruit juices were: (1) Welch's sparkling red grape juice, (2) Kedem sparkling concord grape juice, (3) Knudsen sparkling grape juice, (4) Knudsen sparkling black cherry juice, (5) Knudsen sparkling strawberry juice, (6) Manishevitz sparkling white grape juice, (7) Manishevitz sparkling red grape juice, and (8) Martinelli's sparkling apple juice.

For the purposes of this discussion, then, we will assume that your account of Mr. Yoshiyama's findings are accurate.

B. Description of the Sparkling Cider.

> "Although R--- did not begin selling the Sparkling Cider until after it became a subsidiary of The K--- Co. in 19XX, the Sparkling Cider is a *carbonated* fruit beverage to which *carbon dioxide* is *added*, just like the items found to be *taxable* in the SBE's 1993 audit of R---.[5] The Sparkling Cider contains the following ingredients: water, apple juice concentrate, citric acid (also known as 'Vitamin C') and carbon dioxide. . . .
>
> "*Citric acid* is *added* to the Sparkling Cider to regulate its acidity, and ultimately its taste. In any given year, the crop of apples used to make the Sparkling Cider may be more tart or more sweet, depending on several factors, the most notable of which is the level of rainfall. By *adding citric acid* to the apple juice, the manufacturer of the Sparkling Cider, J--- & W--- S---, ensures that the flavor of the cider will be consistent from year to year.
>
> "The manufacturer also *adds carbon dioxide* to the Sparkling Cider to *carbonate* it and make its "texture" more appealing to consumers. Carbon dioxide is not naturally occurring in apples or in apple juice.[6] The apple juice does not otherwise become carbonated through the manufacturing process. Rather, the manufacturer infuses the *additive carbon dioxide* to carbonate the beverage and alter its texture to that which it believes will maximize the marketability of the beverage. The manufacturer describes the resulting texture as 'sparkling good *carbonation* with slightly crisp mouth fill.'"

(Italics in original. References to Exhibits omitted.)

II. OPINION

A. Sales and Use Tax Generally.

In California, except where specifically exempted by statute, Revenue and Taxation Code section 6051 imposes a sales tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail in this state. (Unless otherwise stated, all statutory references are to the Revenue and Taxation Code.) "[I]t shall be presumed

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[5] As to Martinelli's Sparkling Apple Juice, see *I. D. Foods Superior Corp. v. The Deputy Minister of National Revenue* (Canadian Intl. Trade Tribunal, Nov. 29, 1995) Appeal No. AP-4-102) (6/8/95) < http://www.citt-tcce.gc.ca/appeals/decision/ap94102_e.asp> (as of 11/29/05), in which Martinelli's testified that carbon dioxide was added to its apple juice to produce the sparkling effect.)

[6] In Europe and Oceania, "cider" is an alcolholic beverage in which fermentation is allowed to occur naturally, producing carbon dioxide bubbles in the process. In North America, alcoholic cider is called "hard cider" or "alcoholic cider." Fermentation occurs naturally only when making alcoholic cider. (Wikipedia, *Cider* <http://en.wikipedia.org/wiki/Cider> (as of Nov. 29, 2005).)

that all gross receipts are subject to tax until the contrary is established. . . ." (§ 6091.) "Exemptions from taxation must be found in the statute." (*Market St. Ry. Co. v. St. Bd. of Equal.* (1953) 137 Cal.App.2d 87, 96.)

B. Food Products Exemption.

Section 6359, as interpreted and implemented by Regulation 1602,[7] provides an exemption from sales and use taxes for sales of food products for human consumption under certain circumstances. Subdivision (b)(3) of Section 6359 lists "fruit juices" as food products but also lists "carbonated beverages" as being excluded from the definition of food products. This creates an apparent conflict with respect to the taxation of sales of carbonated fruit juices.

C. Sales of Sparkling Cider.

As you note, regarding sales of sparkling fruit juices, we have previously concluded as follows:

> "Carbonated products which are considered 100% natural fruit juices qualify as exempt 'food products'. If the carbonated product includes a preservative, such as sodium benzoate, or any other additive, it will not be considered a natural fruit juice and tax will apply to its sale."

(Annot. 245.0285 (3/5/87).)[8]

This annotation is derived ultimately from a decision the Board Members made in 1978 in order to resolve a taxpayer's appeal from an adverse result at audit. In that case, the Board had to reconcile the apparent conflict regarding the taxation of sales of carbonated fruit juices discussed above. (See § 6359, subd. (b)(3)[9].) The Board Members therein concluded that carbon dioxide is not the kind of "additive" that would cause carbonated 100-percent fruit juice to be excluded from the term "food products" within the meaning of Section 6359, subdivision (b)(3). Therefore, R--- should stop reporting tax on sales of these products starting with this quarter's return. If, however, R--- has already collected sales tax reimbursement on sales of such products this quarter, it must remit that sales tax reimbursement with this quarter's return.

According to your letter, Mr. Yoshiyama instructed R--- to pay tax on its sales of Sparking Cider. You also state that Mr. Yoshiyama's findings were given as part of an audit in 1993. You do not indicate that R--- contested Mr. Yoshiyama's findings, so the audit

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[7] All regulatory references are to title 18 of California Code of Regulations.

[8] "'Annotations' are published in either the Business Taxes Law Guide or the Property Taxes Law Guide and are summaries of the conclusions reached in selected legal rulings of counsel." (Reg. 5200, subd. (a)(1).) "Annotations provide notice of the existence of and conclusions reached in selected legal rulings of counsel regarding the application of the statutory law, regulatory law, or judicial opinions to a particular factual circumstance." (Reg. 5200, subd. (c)(1).) A copy of Annotation 245.0285 is enclosed for your reference.

[9] The version of section 6359 that exists today was enacted by the voters as part of Proposition 163 at the General Election on November 4, 1992. The voters made changes to other parts of the statute, but subdivision (b)(3) remained unchanged. We must presume that the voters re-enacted subdivision (b)(3) with full knowledge of the Board's interpretation of the statute regarding carbonated fruit juices, as Annotation 245.0285 had been published for five years at that point. (See, e.g., *Universal Eng. Co. v. St. Bd. of Equal.* (1953) 118 Cal.App.2d 36, 43.)

presumably went final and became binding on R--- thirty days after the resulting determination was issued. (§§ 6481 & 6561.) Once the audit went final, any taxes imposed pursuant to the audit became due and payable. (§ 6565.)

The courts have recognized that the business community has placed great reliance on the advice of the Board to order its affairs. (See, e.g., *Yamaha Corp. of Am. v. St. Bd. of. Equal.* (1998) 19 Cal.4th 1, 22, Mosk, J., concur.) R--- paid sales tax and collected sales tax reimbursement under a mistake of law based on an incorrect legal finding by Board personnel. R--- did not know of the error at the time. Thus, we conclude that R---' reliance on Mr. Yoshiyama's instructions was entirely reasonable.

D. Retailer's Obligations under the Sales and Use Tax Law.

The retailer owes the sales tax but may collect sales tax reimbursement from the purchaser pursuant to agreement. (Civ. Code, § 1656.1.) In over-the-counter transactions such as the ones at issue in your letter, such agreements are implied if certain conditions are met. (Civ. Code, § 1656.1, subd. (a).) They are not, however, true arm's-length commercial agreements but are implied by statute in order to facilitate the collection of sales tax. (See *Roth Drug v. Johnson* (1936) 13 Cal.App.2d 720, 738.)

A retailer who has collected sales tax reimbursement is obligated to remit those moneys to the Board with its sales and use tax return. (See § 6451.) Otherwise, the retailer is unjustly enriched. You indicate that R--- complied with the law and remitted the sales tax reimbursement it collected on the sales at issue to the Board with its regular returns.

What if the retailer paid sales tax and collected sales tax reimbursement when it should not have done so? In this case, R--- paid tax and collected sales tax reimbursement in reliance on the specific instruction, albeit a mistaken instruction, of a Board auditor in a 1993 audit. It then transmitted those moneys to the Board with its regular return, as it was required to do.

Regarding excess tax reimbursement, section 6901.5, provides as follows:

> "When an amount represented by a person to a customer as constituting reimbursement for taxes due under this part is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid shall be returned by the person to the customer upon notification by the Board of Equalization or by the customer that such excess has been ascertained. In the event of his or her failure or refusal to do so, the amount so paid, if knowingly or mistakenly computed by the person upon an amount that is not taxable or is in excess of the taxable amount, shall be remitted by that person to this state. Notwithstanding subdivision (b) of Section 6904, those amounts remitted to the state shall be credited by the board on any amounts due and payable under this part on the same transaction from the person by whom it was paid to this state and the balance, if any, shall constitute an obligation due from the person to this state."

Section 6901.5 presupposes that the retailer has not yet remitted the tax moneys to the Board, which is not the case here, but it provides a pattern for resolving this issue. (See *Decorative Carpets, Inc. v. St. Bd. of Equal* (1962) 58 Cal.2d 252, 255-256.)

Section 6901.5 gives the retailer a choice of what to do with the any excess tax reimbursement it still has, once there has been a determination that excess tax reimbursement has in fact been collected.[10] The retailer can (1) refund the money to the customer; or (2) remit it to the State. You state, however, that the retailer, R---, has already filed its returns for the tax quarters at issue and remitted the moneys to the State, as it is required to do. (§§ 6451 & 6452.) A retailer may not retain the moneys it collects as sales tax reimbursement but must remit them to the state. (*Decorative Carpets, supra*, 58 Cal.2d at p. 255.) As a result, R--- has complied with its duties under the Sales and Use Tax Law as to the sales tax reimbursement.[11]

The Board's ability to grant refunds is entirely a matter of legislative grace. (*Hotel Del Coronado Corp. v. St. Bd. of Equal.* (1971) 15 Cal.App.3d 612, 617.) The Board may only grant a tax refund to the person who paid the tax. (§ 6901.) Consequently, the sole legal avenue available for determining the proper application of tax in this case is for R--- to submit a claim for refund under Section 6901 et seq. (Cal. Const., art. XIII, § 32; *St. Bd. of Equal. v. Sup. Ct.* (1985) 39 Cal.3d 633, 638; see also *Yamaha Corp v. St. Bd. of Equal.* (1999) 19 Cal.4th 1, 14.) If the Board were to deny its claim for refund, R--- could pursue an action in court for refund of sales tax under Section 6933.[12] There is no provision in the law for an action on the part of a nontaxpayer to dispute the application of tax.[13]

Javor v. State Bd. of Equal. (1974) 12 Cal.3d 790 does not provide adequate authority for consumers to sue the state to determine if refunds of tax should be granted. In that case, the tax in question was repealed retroactively after it was collected. Thus, the plaintiffs' right to a refund had already been determined before the litigation started. The sole question before the court was how consumers were to get refunds of the tax reimbursement that was due to them. (*Ibid*. at pp. 792-793.) *Javor* most definitely does not stand for the proposition that consumers may sue the retailer for the purpose of determining if tax reimbursement was properly collected at the outset.[14]

In summary, sales of R--- Private Selection Sparkling Cider with carbonation added are not subject to tax under Section 6359, subdivision (b)(3). R---, however, reasonably relied on instructions from a Board auditor and paid sales tax and collected sales tax reimbursement on its sales of carbonated fruit juice from and after the audit. When R--- filed its returns and remitted its payments to the State, it complied with its obligations to file returns and pay tax under the

[10] We understand from your letter that no such determination has been made.
[11] The plaintiffs may be arguing that it has not been established that R--- did report and pay the sales tax to the Board. Reporting and remitting tax is required by the statutes, so the Board must presume that R--- complied with its statutory duties and remitted the money at issue to the Board. (See, e.g., Evid. Code, § 664.)
[12] We note that, even if R--- were to show that a refund was warranted, the Board could not grant the refund if R--- could not identify the customers who paid the sales tax reimbursement to R---s. (*Decorative Carpets, supra,* 58 Cal.2d at p. 255.) In over-the-counter transactions, identifying the customers is nearly impossible.
[13] "A nontaxpayer's interest in the subject matter does not remove the litigation from the bar of Revenue and Taxation Code section [6931], however." (*Connolly v. County of Orange* (1992) 1 Cal.4th 1105, 1115.)
[14] We note that *Javor*'s continued viability is in serious question after *Woosley v. State* (1992) 3 Cal.4th 758.

Revenue and Taxation Code. If R--- had not yet remitted the moneys, it would have the choice, under Section 6901.5, of either refunding the moneys to the specific customers or turning it over to the Board. Because R--- has already remitted to the Board the sales tax revenue derived from the transactions at issue, however, the sole method to determine if tax was properly applied is a tax refund action under Section 6901 et seq.

Sincerely,

John L. Waid
Senior Tax Counsel

JLW/ef

Enclosure: Sales and Use Tax Annotation 245.0287

cc: Ms. Janice Thurston (MIC:82)