
SENATE COMMITTEE ON PUBLIC SAFETY

Senator Loni Hancock, Chair

2015 - 2016 Regular

Bill No: AB 160 **Hearing Date:** June 30, 2015
Author: Dababneh
Version: June 16, 2015
Urgency: No **Fiscal:** Yes
Consultant: JM

Subject: *Criminal Profiteering: Counterfeit Labels: Sales and Use Taxes*

HISTORY

Source: Jerome Horton, Chairman of the Board of Equalization

Prior Legislation: AB 2681 (Dababneh) - Ch. 477, Stats. 2014
AB 90 (Swanson) - Ch. 457 Stats. 2011
AB 924 (Emmerson) - Ch. 111, Stats. 2007
AB 988 (Bogh) - Ch. 53, Stats. 2005
SB 968 (Bowen) - Ch. 125, Stats. 2004
AB 1990 (Liu) - Ch. 991, Stats. 2002
AB 662 (Wesson) - 1999, vetoed

Support: Association of Federal State County and Municipal Employees; California Chamber of Commerce; California District Attorneys Association; California College and University Police Chiefs; California Police Chiefs Association; California Retailers Association California State Sheriffs' Association; California Statewide Law Enforcement Coalition; California State Lodge; Fraternal Order of Police; Independent Insurance Agents and Brokers of California; Liberty Mutual Insurance; Long Beach Police Officers Association; Los Angeles Area Chamber of Commerce; Los Angeles County Professional Peace Officers Association; Motion Picture Association of America, Inc.; Sacramento County Deputy Sheriffs' Association; Valley Industry and Commerce Association

Opposition: None known

Assembly Floor Vote: 77 - 0

PURPOSE

The purpose of this bill is to 1) add piracy of musical or audiovisual works, and unemployment insurance fraud to the list of crimes for which criminal asset forfeiture is authorized; 2) expand the definition of "organized crime" for purposes of criminal asset forfeiture to include pimping and pandering, loan-sharking, trademark counterfeiting, the piracy of a recording or audiovisual work, embezzlement, securities fraud, unemployment insurance fraud, grand theft, money laundering, and forgery; 3) define a "retail sale" or "sale at retail" to include any sale by a convicted seller of tangible personal property with a counterfeit label or an illicit label; 4) provide that "storage" and "use" include a purchase by a convicted purchaser of tangible personal property with a counterfeit label or an illicit label; and 5) define "counterfeit

label” and “illicit label” as those terms are defined in federal law - a label that appears to be genuine but is not, and a genuine label that a person uses without authorization respectively.

Existing law:

Includes the criminal profiteering asset forfeiture law, which applies where the defendant is convicted of a specified offense and the defendant has engaged in a pattern of criminal profiteering activity, as specified. (Pen. Code § 186.3.) The following assets or property are subject to forfeiture:

- Any property interest whether tangible or intangible, acquired through a pattern of criminal profiteering activity.
- All proceeds of a pattern of criminal profiteering activity, which property shall include all things of value that may have been received in exchange for the proceeds immediately derived from the pattern of criminal profiteering activity.

Existing law states that forfeited cash and proceeds of the sale of forfeited property shall be distributed as follows:

- To the bona fide or innocent purchaser, conditional sales vendor, or holder of a valid lien, mortgage, or security interest, up to the amount of his or her interest in the property or proceeds, as specified.
- To the Department of General Services or local governmental entity for all expenditures incurred in connection with the sale of the forfeited property.
- To the State General Fund or the general fund of the local governmental entity, whichever prosecutes. (Pen. Code § 186.8), except in the child pornography or recycling fraud cases.
- In a case of fraud involving the state recycling program, to a special fund designated in the Public Resources Code.
- In the case of child pornography crimes, to the county children’s trust fund or State Children’s Trust Fund.
- In a case involving human trafficking of minors for purposes of prostitution or lewd conduct, or a case of procurement of a minor, to the Victim-Witness Assistance Fund for child sexual exploitation and abuse counseling and prevention programs. Fifty percent of the funds shall be granted to community-based organizations that serve minor victims of human trafficking.

Existing law states that any person who willfully manufactures, intentionally sells, or knowingly possesses for sale any counterfeit of a mark registered with the California Secretary of State or registered on the United States Patent and Trademark Office shall be punishable as follows:

- If the offense involves less than 1,000 of the articles with a total retail value less than the standard for grand theft (over \$400 - \$487), the defendant is guilty of a misdemeanor, punishable by a fine of not more than \$5000, imprisonment in a county jail for up to one year, or by both. If the defendant is a corporation, by a fine of not more than \$100,000.
- When the crime involves 1,000 or more articles, or has a total retail value that meets the standard for grand theft (over \$400 - \$487), the crime is an alternate

felony-misdemeanor, punishable by imprisonment in a county jail for up to one year, or in the state prison for 16 months, 2 years or 3 years, by a fine not to exceed \$250,000, or both. If the defendant is a corporation, the maximum fine is \$500,000. (Pen. Code § 350, subd. (a).)

Existing law provides that a repeated violation of the counterfeit trademark statute is an alternate felony-misdemeanor, punishable by a fine of not more than \$50,000, imprisonment in a county jail for not more than one year, or in the state prison for 16 months, or 2 or 3 years, or both. If the defendant is a corporation, the maximum fine is \$200,000. (Pen. Code § 350, subd. (b).)

Existing law provides that where a defendant is convicted of a trademark counterfeiting, the court shall order the forfeiture and destruction of all of counterfeit marks and all counterfeit items. The court, with specified exceptions for community property vehicles, shall also order forfeiture and destruction or other disposition of all means of making the marks, and all other devices for making or transporting the marks used in connection with the violation.

Existing law describes "fair use" of a trademark, which is not subject to prosecution or a civil action, as any of the following:

- advertising or promotion that permits consumers to compare goods or services;
- identifying and parodying, criticizing, or commenting upon the famous mark owner or the goods or services of the famous mark owner;
- noncommercial use of the mark; and
- all forms of news reporting and news commentary. (Bus. & Prof. Code § 14247.)

Existing federal law provides that it is a crime to "traffic" or "attempt to traffic" in counterfeit goods. The crime is punishable by a fine of up to \$2,000,000, imprisonment for up to 10 years, or both. The maximum fine for a corporation or an entity other than an individual is \$5,000,000. Repeated convictions are punishable by imprisonment for up to 20 years, a fine of up to \$5,000,000, or both. Where the convicted defendant of repeated violations is other than an individual the maximum fine is \$15,000,000. (18 U.S.C. § 2320.)

Existing federal law provides the following property is subject to forfeiture following a defendant's conviction for trafficking in counterfeit goods: the proceeds of the crime; any of the defendant's property used or intended to be used in the crime; any article bearing a counterfeit mark. (18 U.S.C. § 2320 (b).)

This bill:

Expands the list of offenses that can serve as a basis for criminal profiteering asset forfeiture - employed against organized crime - to include piracy of audio or audiovisual works and unemployment insurance fraud.

Expands provisions from the "organized crime" element as it pertains to criminal profiteering by the provisions that require that the nature of the conspiratorial action be of an organized nature to include such examples as:

- pimping and pandering;
- counterfeiting of any registered trademark;

- illegal piracy of recordings or audiovisual works;
- embezzlement;
- securities fraud;
- state tax fraud;
- unemployment insurance fraud;
- grand theft;
- money laundering; and
- forgery.

Adds, to the definition of a "retail sale" or "sale at retail," the sale of tangible personal property (TPP) with a counterfeit or illicit label regardless of whether the sale is for resale in the regular course of business.

Adds, to the definition of "storage" or "use," a purchase by a convicted purchaser of TPP in connection with a counterfeit label or illicit label, regardless of whether the purchase is for resale in the regular course of business.

Defines "counterfeit label" as having the same meaning as United States Code (USC), Title 18, Section 2318 - a label that appears to be genuine, but is not.

Defines "illicit label" as having the same meaning as USC, Title 18, Section 2318 - a genuine label that is used without authorization.

RECEIVERSHIP/OVERCROWDING CRISIS AGGRAVATION

For the past eight years, this Committee has scrutinized legislation referred to its jurisdiction for any potential impact on prison overcrowding. Mindful of the United States Supreme Court ruling and federal court orders relating to the state's ability to provide a constitutional level of health care to its inmate population and the related issue of prison overcrowding, this Committee has applied its "ROCA" policy as a content-neutral, provisional measure necessary to ensure that the Legislature does not erode progress in reducing prison overcrowding.

On February 10, 2014, the federal court ordered California to reduce its in-state adult institution population to 137.5% of design capacity by February 28, 2016, as follows:

- 143% of design bed capacity by June 30, 2014;
- 141.5% of design bed capacity by February 28, 2015; and,
- 137.5% of design bed capacity by February 28, 2016.

In February of this year the administration reported that as "of February 11, 2015, 112,993 inmates were housed in the State's 34 adult institutions, which amounts to 136.6% of design bed capacity, and 8,828 inmates were housed in out-of-state facilities. This current population is now below the court-ordered reduction to 137.5% of design bed capacity."(Defendants' February 2015 Status Report In Response To February 10, 2014 Order, 2:90-cv-00520 KJM DAD PC, 3-Judge Court, *Coleman v. Brown, Plata v. Brown* (fn. omitted).

While significant gains have been made in reducing the prison population, the state now must stabilize these advances and demonstrate to the federal court that California has in place the "durable solution" to prison overcrowding "consistently demanded" by the court. (Opinion Re:

Order Granting in Part and Denying in Part Defendants' Request For Extension of December 31, 2013 Deadline, NO. 2:90-cv-0520 LKK DAD (PC), 3-Judge Court, *Coleman v. Brown, Plata v. Brown* (2-10-14). The Committee's consideration of bills that may impact the prison population therefore will be informed by the following questions:

- Whether a proposal erodes a measure which has contributed to reducing the prison population;
- Whether a proposal addresses a major area of public safety or criminal activity for which there is no other reasonable, appropriate remedy;
- Whether a proposal addresses a crime which is directly dangerous to the physical safety of others for which there is no other reasonably appropriate sanction;
- Whether a proposal corrects a constitutional problem or legislative drafting error; and

Whether a proposal proposes penalties which are proportionate, and cannot be achieved through any other reasonably appropriate remedy.

COMMENTS

1. Need for This Bill

According to the author:

The problem with current Penal Code section 186.2 is that it is internally inconsistent. The list of 33 crimes set forth in subd. (a) to which the statute is supposed to apply, does not mesh with the additional requirements found in subd. (d), i.e., that it also be "organized crime." "Organized crime" is defined in such a way in subdivision (d) (by listing 12 other types of illegal activity), that it is hard to match it up with one of the 33 enumerated crimes the statute was intended to address.

Additionally, the list of crimes addressed in Penal Code 186.2 is deficient; it does not take into account all of the crimes that make up the underground economy. Indeed, after over a year of investigation and testimony, the Little Hoover Commission released on March 9, 2015, a report about underground economy crimes (tax evasion, counterfeiting, worker's comp fraud, etc.) and listed as one of its recommendations that "The state should refine and expand its asset seizure laws to improve the collection of victim restitution." (Lit. Hov. Comm. Report, #226, p. x.) The report specifically mentions AB 160 in this regard.

2. The Basics of Criminal Asset Forfeiture

History: In 1982, the California Legislature passed the California Control of Profits of Organized Crime Act. The express purpose of the Act was to punish the activities of organized crime through the forfeiture of profits acquired and accumulated as a result of engaging in a pattern of criminal profiteering activity. All property gained through that activity is subject to forfeiture. (Penal Code §§ 186 and 186.1.)

Procedure: Criminal profiteering asset forfeiture is a criminal proceeding held in conjunction with the trial of the underlying criminal offense. Often, the same jury that heard the criminal charges determines whether the defendant's assets were the ill-gotten gains of criminal profiteering. As a practical matter, the prosecution must assemble its evidence for the forfeiture matter simultaneously with the evidence of the crime.

Proceeds: Under existing law the forfeited proceeds of criminal profiteering are placed in the county general fund with no directions for use. There are limited exceptions. For example, forfeiture in child pornography cases is deposited in the county or State Children's Trust Fund for child abuse and neglect prevention and intervention. (Pen. Code § 186.8; Welf. Inst. Code §§ 18966 and 18969.)

Contrast with Drug Asset Forfeiture: In contrast to criminal asset forfeiture, drug asset forfeiture is a separate civil action. With limited exceptions, a conviction for an underlying drug offense is required. However, the prosecution in drug asset forfeiture can conduct substantial civil discovery to find the defendant's assets. Law enforcement receives 65% of drug forfeiture proceeds. Federal forfeiture law authorizes a federal agency to "adopt" a state seizure and return as much as 80% of the proceeds to the state or local agency. The United States Attorney General has recently limited adoption of state forfeitures. SB 443 (Mitchell) would rewrite the California drug asset forfeiture law. Most notably, SB 443 would prohibit state or local law enforcement agencies from transferring seized property to a federal agency for adoption, require that property seized pursuant to federal law be distributed to state and local law enforcements according to state law formulas, and that convictions be obtained before the agencies could share in federal forfeiture proceeds.

3. Expansion of the Control of Profits of Organized Crime Act - Criminal Asset Forfeiture

It was the intent of the Legislature, when enacting the criminal asset forfeiture law, to punish and deter criminal activities of organized crime through the forfeiture of profits acquired and accumulated as a result of such criminal activities. Criminal asset forfeiture is allowed upon conviction of more than 30 crimes, including extortion, pimping and pandering, robbery, grand theft, trafficking in controlled substance, money laundering, and offenses related to counterfeiting. Proceeds can be forfeited if the proceeds were gained through a pattern of criminal activity and were gained through involvement in organized crime. This bill adds offenses related to music and video piracy and unemployment insurance fraud to the list of "criminal profiteering activity." The bill also matches the definition of "organized crime" - to the list of specific crimes for which criminal asset forfeiture is authorized. That is, the bill essentially what members of criminal organizations do match what how criminal organizations are defined.

4. The Underground Economy

The underground economy is a well-documented problem in the State of California. The Board of Equalization (BOE) has estimated that \$8 billion in corporate, personal, and sales and use tax (SUT) revenues go uncollected in California each year, with unreported and underreported economic activity responsible for the vast majority of that total, placing a burden on state and local governments, and legitimate businesses; tackling the problem has not been easy. In 1993, the Joint Enforcement Strike Force was created to combat the underground economy by aiding in the sharing of information, coordinating enforcement efforts, and developing methods to target enforcement resources. Additionally, the Labor Task Force has also been launched in an effort

to curb the underground economy. Through its information sharing program, the Labor Task Force attempts to ensure that employees receive proper payments and that California receives all employment taxes and fees owed

5. Sales and Use Tax on Counterfeit Items

AB 2681 (Dababneh), Chapter 477, Statutes of 2014, expanded the definition of "retail sale" or "sale at retail" to include any sale by a convicted seller of TPP with a counterfeit mark regardless of whether the sale is for resale in the regular course of business. This bill again expands the definition to further include "counterfeit label" and "illicit label."

It is unclear if imposing a tax on counterfeit items, regardless of whether the sale is for resale in the regular course of business, would discourage criminals from selling counterfeit items. Like most business models, a seller of counterfeit goods makes a profit if sales revenues exceed costs. However, unlike legitimate businesses, sellers of counterfeit goods must additionally take into account the potential costs of government prosecution and civil lawsuits from genuine producers. These considerations may have a huge impact on a seller's decision to carry counterfeit items, especially if the government has improved enforcement of trademark laws or increased sentences. The more active the government becomes in enforcing laws, the more likely sellers will choose not to carry counterfeit products. The threat of sales tax, on its face, may be seen as one additional tool to deter a person from selling counterfeit items because it increases the costs of doing business. However, the collection of sales tax is secondary to the threat of being caught. Thus, a person selling counterfeit goods would not likely be deterred by the possibility of having to remit sales tax, especially when the imposition of the tax is only imposed after a conviction.

However, there are well-known cases where organized criminals were prosecuted for tax fraud when prosecutors had difficulty proving the crimes from which the organizations derived income that was not reported. The most notable and well-known case is the conviction of Al Capone for tax fraud.¹ Tax fraud charges could also be used in plea bargaining.

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¹ <http://law2.umkc.edu/faculty/projects/ftrials/capone/caponeaccount.html>