

SALES AND USE TAXES

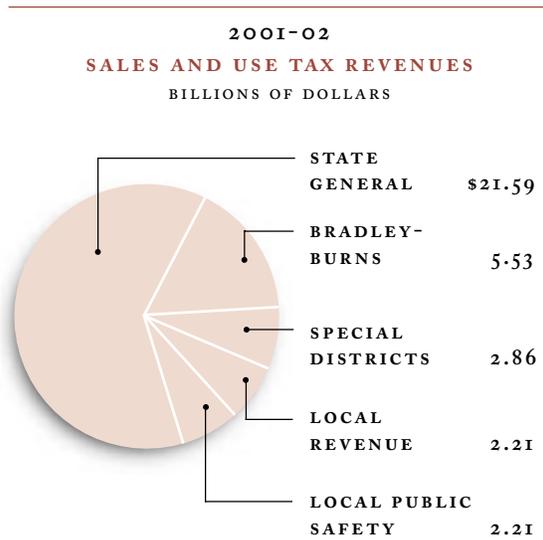
REVENUES

California sales and use tax revenue totaled \$34.4 billion in 2001-02, a decrease of 2.7 percent from the previous year's total of \$35.4 billion. Fiscal year 2001-02 revenues and tax rates included:

- \$26.0 billion from the state sales tax, with
 - \$21.6 billion allocated to the state's General Fund; tax rate of 4.75 percent from July 1, 2001, through December 31, 2001; 5.00 percent from January 1 through June 30, 2002.
 - \$2.21 billion allocated to the state's Local Revenue Fund; tax rate of 0.50 percent.
 - \$2.21 billion allocated to the Local Public Safety Fund; tax rate of 0.50 percent.

- \$5.53 billion from the Bradley-Burns Uniform Local Sales and Use Tax, allocated among all of the state’s 58 counties and 477 cities; tax rate of 1.25 percent.
- \$2.86 billion in special district transactions (sales) and use tax; rates vary by district.

2001-02 revenues allocated to the state General Fund, \$21.6 billion, were 2.1 percent lower than revenues for 2000-01.



PROGRAMS

California’s sales tax, paid by retailers engaged in business in the state, applies to all retail sales of goods and merchandise except those sales specifically exempted by law. The use tax generally applies to the storage, use, or other consumption in California of goods purchased from retailers in transactions not subject to the sales tax. Use tax may also apply to purchases

shipped to a California consumer from another state, including purchases made by mail order, telephone, or Internet.

The sales and use tax rate in a given California location comprises three parts: the state tax rate, the local tax rate, and the district tax rate (if any). The statewide combined sales and local tax rate was 7 percent from January 1, 2001, through December 31, 2001 (5.75 percent state tax rate and 1.25 percent local tax rate).

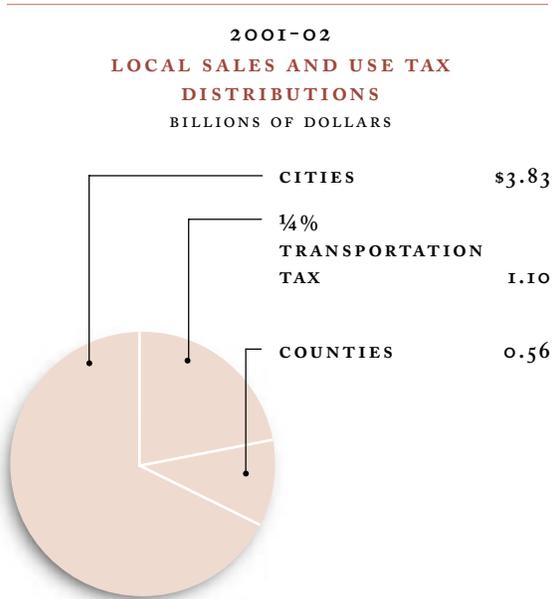
On January 1, 2002, the General Fund portion of the state tax rate increased by 0.25 percent, to 5.00 percent (see “Highlights,” page 12). This change raised the total state portion of the sales and use tax rate to 6.00 percent and returned the combined statewide rate to 7.25 percent—the rate that had been in effect from December 1, 1989, through December 31, 2000.

State sales and use taxes provide revenue to the state’s General Fund, to cities and counties through specific state fund allocations, and to other local jurisdictions.

Local Sales and Use Tax

The Board of Equalization collects and allocates the 1.25 percent Bradley-Burns Uniform Local Sales and Use Tax on behalf of all California cities and counties. For each sale, 0.25 percent of the local tax is allocated to the county where the sale occurs, for transportation projects. The remaining one percent local tax is allocated to the county or an incorporated city, generally depending on the location of the sale.

City and county local tax distributions are detailed in Table 21A of the Appendix, beginning on page A-26.



Redevelopment Agencies. Between 1981 and 1994, cities could finance redevelopment projects with revenue derived from the local sales and use tax and distributed under agreement to city redevelopment agencies. While this authority was repealed effective January 1, 1994, existing city ordinances were permitted to continue. Thirty-six redevelopment projects in 26 California cities were receiving sales and use tax revenue as of June 30, 2002.

District Transactions (Sales) and Use Tax

The Board of Equalization collects and distributes district transactions (sales) and use tax on behalf of voter-approved special tax districts throughout the state. While the first special districts funded local and regional transportation projects, newer districts fund schools, open space protection, hospitals, county services, and public libraries. Some California locations lie within more than one tax district. A complete

list of special tax districts, jurisdictions, and revenues is found in Appendix [Table 21C](#), on page A-30.

There were 38 special tax districts in effect at the beginning of the 2001-02 fiscal year, with rates ranging from 0.125 percent to 0.50 percent. The only special district tax changes in 2001-02 were in Alameda County. The existing Alameda County Transportation Authority tax expired on March 31, 2002. It was replaced immediately by the Alameda County Transportation Improvement Authority tax. Since both the expiring and new taxes had the same rate—0.50 percent—the tax rate in Alameda County remained constant at 8.25 percent.

Sales made by retailers engaged in business in a special tax district are subject to a total sales tax rate that includes the statewide rate and the applicable district tax rate (see Appendix [Table 23B](#), on page A-33). While the provisions of the Transactions and Use Tax Law are similar to state and local sales and use tax laws, significant differences do exist. These include an exemption for sales shipped to a location outside the district for use in that location and special requirements for sales of registered vehicles, aircraft, and undocumented vessels.

OPERATIONS

The Board encourages voluntary tax law compliance and offers sales and use tax assistance through its Sacramento headquarters and 26 field offices located across the state. Staff in Board offices in New York, Chicago, and Houston assist taxpayers located outside California who are registered to do business in this state.

The number of registered sellers increased this fiscal year, totaling 1,011,146 as of June 30, 2002. The agency processed more than 3.8 million sales and use tax returns.

Compliance Activities

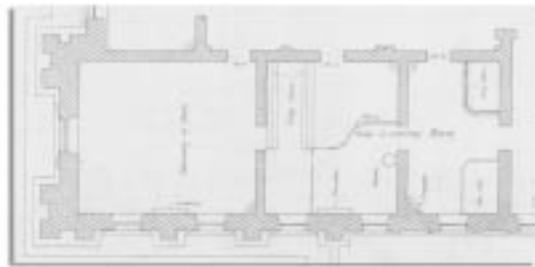
Board compliance staff ensure that sellers properly comply with permit requirements, assist them in interpreting tax laws and regulations, provide classroom instruction and individual assistance in the correct preparation of tax returns, and collect outstanding tax amounts. In 2001-02, compliance staff collected more than \$546 million in delinquent sales and use taxes.

Consumer Use Tax Section

The Consumer Use Tax Section works closely with state and federal agencies in administering the use tax due on nondealer sales of vehicles, vessels, aircraft, and mobile homes and on purchases identified on customs declarations. In 2001-02, revenues totaled \$626.6 million, including funds collected by the Board and

- \$535.9 million collected by the Department of Motor Vehicles.
- \$8.8 million collected by the Department of Housing and Community Development.

Consumer use tax revenues this fiscal year increased by 2.4 percent over 2000-01.



Audit Program

The Board maintains an effective audit program to ensure that businesses report neither more nor less tax than required. The program audits nearly 1.5 percent of active accounts each year, concentrating on those considered most likely to be inaccurate in their tax reporting. In fiscal year 2001-02, the sales and use tax audit program disclosed net deficiencies of more than \$339.9 million. Taxpayers received nearly \$110.5 million in sales and use tax refunds.

Areas of Taxpayer Noncompliance

To comply with requirements of the Taxpayers' Bill of Rights, the Board annually

- Identifies the areas of the Sales and Use Tax Law where taxpayer noncompliance is highest.
- Classifies the types of businesses making errors.

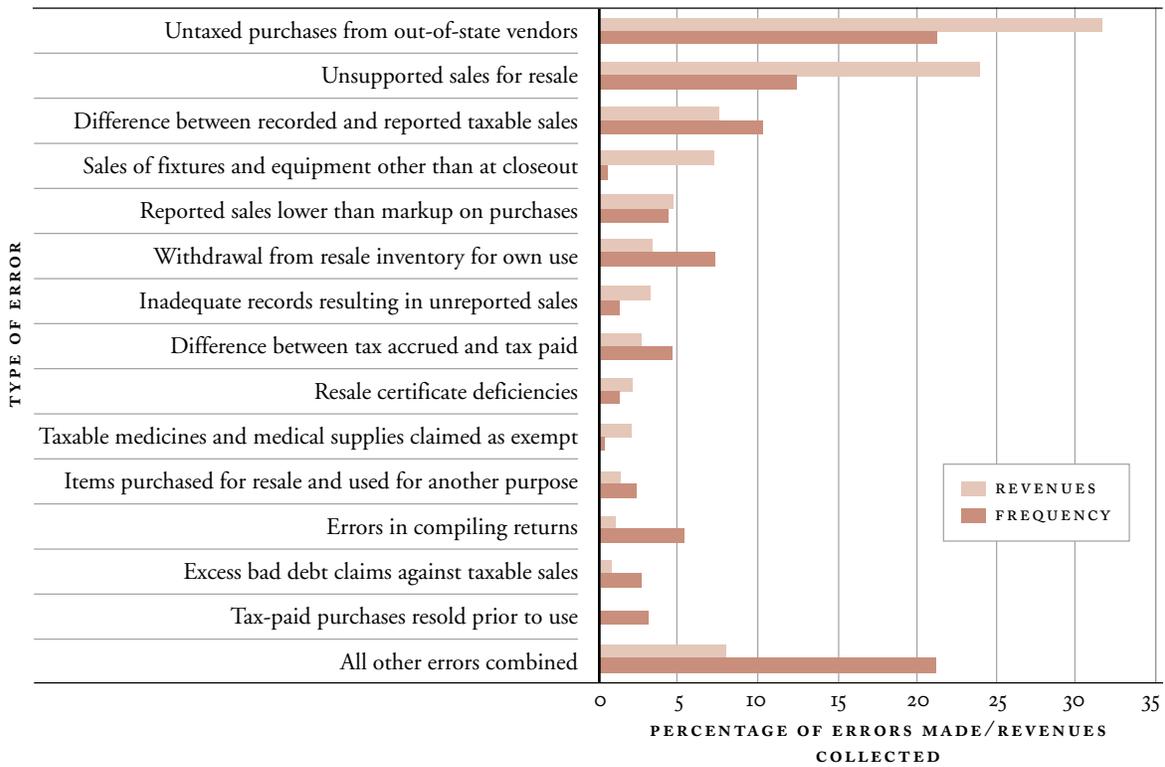
The most frequent and costly category of taxpayer noncompliance in 2001-02 was failure to pay use tax on purchases from out-of-state vendors. Nearly 31.5 percent of net sales and use tax audit deficiencies occurred in that category—totaling more than \$78 million in unpaid tax. Ranking close behind this category in both frequency of occurrence and amount of revenue were sales for resale made without supporting documentation. This noncompliance category accounted for nearly 24 percent of all net sales and use tax audit deficiencies, or more than \$59 million in unpaid tax.

The charts on the next page summarize the Board's findings on the types of taxpayer noncompliance for fiscal year 2001-02 and provide other tax compliance information required by the Taxpayers' Bill of Rights.

ANALYSIS OF SALES AND USE TAX NONCOMPLIANCE, 2001-02

TYPES OF NONCOMPLIANCE

FREQUENCY OF ERRORS/REVENUES COLLECTED



TYPES OF BUSINESS MAKING ERROR

RANKED BY REVENUES COLLECTED

Type of Business	Percentage	Rank for 2000-01
Publishers; Producers and Distributors of Light Industrial Equipment	16.71	1
Repair and Hand Trade Shops	9.03	5
Public Utilities, Transportation, and Allied Services	5.87	3
Manufacturers and Wholesalers of Electronic Equipment	5.57	2
Office Stores and School Furniture Equipment Stores	5.26	9
Construction Contractors and Wholesalers of Building Materials	4.39	10
Department Stores and Mail Order Retail Stores	3.87	28
Manufacturers and Wholesalers of Drugs and Chemicals	3.67	8
Producers and Distributors of Heavy Industrial Equipment	3.42	6
Gasoline Stations	3.09	72
All Other Businesses	39.12	
TOTAL	100.00	

APPEALS

Taxpayers who disagree with Board audit results or other decisions regarding the application of sales and use tax may seek resolution through the Board's administrative appeals process. For information on appeals filed in 2001-02, see chapter 6, "Appeals," which begins on page 45.

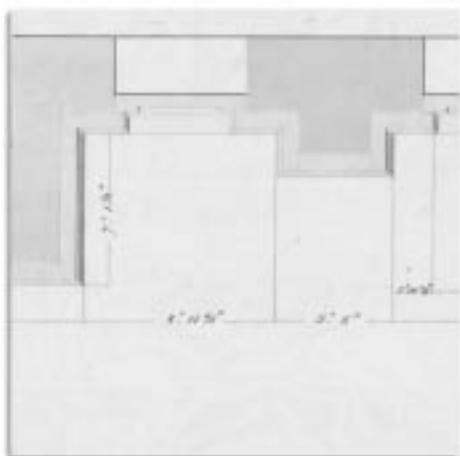
The agency also offers a settlement program as an alternative method of tax dispute resolution. In 2001-02, staff settled 232 sales and use tax cases. The total settlement amount was \$21.91 million.

COURT DECISIONS

Standard of Proof for Civil Tax Fraud

The federal Ninth Circuit Court of Appeal determined that under California law, the standard of proof in civil tax fraud cases is "clear and convincing evidence" instead of "preponderance of the evidence."

Renovizer's Inc. v. California State Board of Equalization (9th Cir. 2002) 282 F.3d 1233



LEGISLATION

Thrift Store Exemption

Extends until January 1, 2007, the existing sales tax exemption for sales of used clothing, household items, or other retail merchandise by thrift stores operated to raise funds for specified AIDS patient services.

Assembly Bill 180, Chapter 383, Statutes of 2001; effective October 1, 2001

Fuel Tax Prepayments

Moves the first point of retail sales tax prepayment on motor vehicle fuel, aircraft jet fuel, and diesel fuel to the terminal rack, to coincide with the imposition of the excise tax. Board-sponsored.

Assembly Bill 309, Chapter 429, Statutes of 2001; effective October 2, 2001, but operative January 1, 2002

Agricultural Exemptions

Fully exempts certain sales and purchases of liquefied petroleum gas (LPG) delivered to qualified residences or to agricultural producers, as defined. Creates a number of agriculture-related exemptions that apply only to the state portion of the sales and use tax, including sales and purchases of the following:

- Farm equipment, machinery, and related parts purchased by qualified agricultural producers or harvesters or anyone who assists them.
- Equipment, machinery, and related parts designed primarily for off-road use in commercial timber harvesting, purchased by a qualified person commercially harvesting timber.
- Diesel fuel used in food processing or farming activities, as defined in Internal Revenue

Code section 263A, including the transportation of farm products to the marketplace.

- Racehorse breeding stock, as defined.

Assembly Bill 426, Chapter 156, Statutes of 2001; effective August 7, 2001, but operative September 1, 2001

Medicine for Outpatient Clinics

Exempts the sale of medicines to clinics, as defined in Health and Safety Code section 1200, when the medicines will be used for treatment ordered by a licensed physician, surgeon, dentist, or podiatrist.

Assembly Bill 646, Chapter 706, Statutes of 2001; effective October 11, 2001, but operative April 1, 2002

Public Passenger Transportation Vehicles

Provides a sales and use tax exemption until January 1, 2004, for the sale and lease-back of public passenger transportation vehicles sold or leased by a transit authority, special district, or governmental entity.

Assembly Bill 984, Chapter 592, Statutes of 2001; effective October 9, 2001, but operative November 1, 2001

Internet Tax Freedom Act Extension

Extends the 1998 Internet Tax Freedom Act, originally set to expire on January 1, 2002, until January 1, 2004, or until January 1, 2003, if the California Commission on Tax Policy in the New Economy fails to submit a specified report. The 1998 Act prohibited new local taxes and fees on Internet access, use, and related services.

Senate Bill 394, Chapter 343, Statutes of 2001; effective January 1, 2002

Third-Party Check Charges

Authorizes the Board to reimburse taxpayers for any third-party charges (such as dishonored check charges) incurred because the agency issued an erroneous levy or earnings-withhold notice. Board-sponsored.

Senate Bill 1185, Chapter 543, Statutes of 2001; effective January 1, 2002

District Tax Authorizations

CITY OF WEST SACRAMENTO

Authorizes the City of West Sacramento, subject to two-thirds or majority voter approval, to levy a transactions and use tax at a rate of 0.25 or 0.50 percent, as specified.

Assembly Bill 863, Chapter 263, Statutes of 2001; effective January 1, 2002

SAN DIEGO COUNTY REGIONAL TRANSPORTATION COMMISSION

Authorizes the San Diego County Regional Transportation Commission, with voter approval, to extend or expand its existing transactions and use tax.

Senate Bill 521, Chapter 297, Statutes of 2001; effective January 1, 2002

FRESNO COUNTY TRANSPORTATION AUTHORITY

Authorizes the Fresno County Transportation Authority, subject to two-thirds voter approval, to levy a transactions and use tax at a rate of 0.50 percent for an additional 30 years. The tax will finance regional transportation improvements.

Senate Bill 685, Chapter 474, Statutes of 2001; effective January 1, 2002

CITY OF SEBASTOPOL

Reduces the voter approval requirement for the existing City of Sebastopol transactions and use tax authority from a two-thirds majority to a simple majority.

Senate Bill 1186, Chapter 292, Statutes of 2001; effective January 1, 2002

FRESNO COUNTY

Authorizes Fresno County, with two-thirds voter approval, to establish a special purpose authority and impose a related transactions and use tax of 0.10 percent to support zoos, zoological facilities, and related zoological purposes.

Senate Bill 1187, Chapter 285, Statutes of 2001; effective September 10, 2001

REGULATIONS

Manufacturing Equipment

Regulation 1525.2, *Manufacturing Equipment*, was amended to permit claims for refund when the partial exemption was not originally claimed in a timely manner. Later, the regulation was amended to conform to Revenue and Taxation Code sections 6051.3, 6051.4, 6201.3, and 6201.4. The changes were related to the January 1, 2002, 0.25 percent increase in the state sales and use tax rate.

Title 18, California Code of Regulations, section 1525.2; effective May 17, 2002

Teleproduction or Other Postproduction Service Equipment

Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*, was amended to conform to Revenue and Taxation Code sections 6051.3, 6051.4, 6201.3, and 6201.4.

The changes were related to the January 1, 2002, 0.25 percent increase in the state sales and use tax rate.

Title 18, California Code of Regulations, section 1532; effective May 17, 2002

Vending Machine Operators

Regulation 1574, *Vending Machines Operators*, was amended to provide a presumption that taxable vending machine sales are made on a tax-included basis, to include the formula for calculating the “cold food factor,” to provide for calculation of the cold food factor in 0.125 percent increments, and to delete obsolete provisions.

Title 18, California Code of Regulations, section 1574; effective October 20, 2001

**Motor Vehicle and Aircraft Fuels;
Federal Taxes**

Regulation 1598, *Motor Vehicle and Aircraft Fuels*, and Regulation 1617, *Federal Taxes*, were amended to provide that under specified circumstances, a qualified purchaser may issue an exemption certificate to a fuel vendor for an amount equal to the sales or use tax on the federal manufacturers’ or importers’ excise tax imposed on the purchaser’s fuel purchases. The changes interpret and implement sections 1, 1.3, and 1.6 of Assembly Bill 2894 (Stats. 2000, ch. 923).

Title 18, California Code of Regulations, sections 1598 and 1617; effective December 1, 2001

Taxable Sales of Food Products

Regulation 1603, *Taxable Sales of Food Products*, was amended to clarify how tax applies to sales and purchases by caterers in a variety of

circumstances and to the sale of food items through “honor boxes.”

Title 18, California Code of Regulations, section 1603; effective June 13, 2002

Interstate and Foreign Commerce

Regulation 1620, *Interstate and Foreign Commerce*, was amended to specify how tax applies to the use of a vessel first functionally used outside California then brought into the state within 90 days of purchase.

Title 18, California Code of Regulations, section 1620; effective February 7, 2002

Bad Debts

Regulation 1642, *Bad Debts*, was amended to provide a “bad debt” deduction for certain third-party lenders. These changes interpret and implement the provisions of Assembly Bill 599 (Stats. 2000, ch. 500).

Title 18, California Code of Regulations, section 1642; effective January 16, 2002

Leases of Tangible Personal Property— in General

Regulation 1660, *Leases of Tangible Personal Property—In General*, was amended to clarify when maintenance and cleaning charges related to the lease of a portable toilet are for services that are a part of the sale, and to specify when related supplies may be purchased for resale.

Title 18, California Code of Regulations, section 1660; effective January 5, 2002

Leases of Mobile Transportation Equipment

Regulation 1661, *Leases of Mobile Transportation Equipment*, was amended to clarify the deadline by which a lessor must elect to pay use

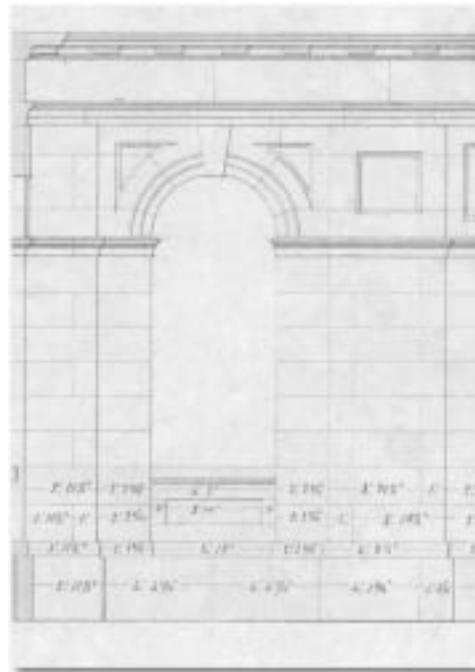
tax liability measured by the fair rental value of mobile transportation equipment, to clarify that a lessor may elect to pay use tax liability on that basis whenever the equipment is purchased without payment of tax, and to make nonsubstantive clarifying changes.

Title 18, California Code of Regulations, section 1661; effective January 3, 2002

Resale Certificates

Regulation 1668, *Resale Certificates*, was amended to clarify the seller’s burden of proving that a sale is for resale and to clarify the purchaser’s liability for tax when purchasing under a resale certificate or for resale, to incorporate specific provisions on the use of the Board’s XYZ resale confirmation letters, and to make grammatical and format changes.

Title 18, California Code of Regulations, section 1668; effective May 17, 2002



Collection of Use Tax by Retailers

Regulation 1684, *Collection of Use Tax by Retailers*, was amended to conform the regulation to reflect changes in the rules regarding the role of trade shows in establishing nexus for use tax collection duties, as specified in Assembly Bill 330 (Stats. 2000, ch. 617), operative January 1, 2001.

Title 18, California Code of Regulations, section 1684; effective August 1, 2001

Permits

Regulation 1699, *Permits*, was amended to define when seller's permits may be issued to "buying companies," as defined, and to explain the conditions under which a seller's website may be issued a seller's permit.

Title 18, California Code of Regulations, section 1699; effective June 14, 2002

Innocent Spouse Relief from Liability

Regulation 1705.1, *Innocent Spouse Relief from Liability*, was amended to provide conditions and procedures under which a claiming spouse may apply for equitable relief; to conform the regulation to the California Personal Income Tax Law and the federal Internal Revenue Code regarding who can file an innocent spouse claim; and in conformity with California Personal Income Tax Law, to require the Board to notify the nonclaiming spouse about a claim for innocent spouse relief or equitable relief and the basis of the claim.

Title 18, California Code of Regulations, section 1705.1; effective October 20, 2001