



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

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| Date Amended: | 03/21/11 | Bill No: | <u>Senate Bill 364</u> |
| Tax Program: | Sales and Use Tax | Author: | Yee |
| Sponsor: | Author | Code Sections: | RTC 6372 |
| Related Bills: | | Effective Date: | 01/01/12 |

BILL SUMMARY

Among other things, with respect to any business tax incentive enacted on or after January 1, 2012, this bill would impose a penalty on a qualified taxpayer up to the amount of the business tax incentive claimed by that taxpayer, as specified, if the taxpayer has a net decrease in the number of full-time employees, as described.

ANALYSIS

CURRENT LAW

Under existing law, California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt or excluded from taxation by statute. This tax is imposed on the retailer who may collect sales tax reimbursement from the customer if the contract of sale so provides. A use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax.

Beginning July 1, 2011, the statewide sales and use tax rate (7.25%) imposed on taxable sales and purchases of tangible personal property is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by various local jurisdictions and are not reflected in this chart):

| Rate | Jurisdiction | Purpose/Authority |
|-------------|--|---|
| 5.00% | State (General Fund) | State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3) |
| 0.25% | State (Fiscal Recovery Fund) | Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04) |
| 0.50% | State (Local Revenue Fund) | Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2) |
| 0.50% | State (Local Public Safety Fund) | Local governments to fund public safety services (Section 35, Article XIII, State Constitution) |
| 1.00% | Local (City/County) 0.75% City and County 0.25% County | City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes |

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| Rate | Jurisdiction | Purpose/Authority |
|-------|----------------------|-------------------|
| 7.25% | Total Statewide Rate | |

The 1% General Fund tax under Sections 6051.7 and 6201.7 will expire on 6/30/11.

PROPOSED LAW

This bill would add Revenue and Taxation Code Section 6372 to the Sales and Use Tax Law to specify that a qualified taxpayer that claims a business tax incentive enacted on and after January 1, 2012 against the sales and use tax imposed, shall pay a penalty up to the value of the business tax incentive claimed, if the taxpayer has a net decrease in the number of full-time employees.

The bill defines the following terms:

- "Qualified taxpayer" would mean a taxpayer engaged in or carrying on a trade, business, profession, vocation, calling, or commercial activity in this state with 101 or more employees.
- "Business tax incentive" would mean a credit, deduction, exclusion, exemption, or any other tax benefit provided by the state that is added by an act that takes effect beginning on or after January 1, 2012, and enacted with the purpose of creating new jobs in the state.
- "Net decrease" would mean when the decrease in the number of qualified full-time employees, determined on an annual full-time equivalent basis, is equal to or greater than 10 percent of the total workforce of the qualified taxpayer in this state.

The penalty proposed in the bill would be \$5,000 for each qualified full-time employee that is a net decrease over the decrease of 10 percent of the taxpayer's workforce. However, the bill would specify that the penalty shall not exceed the total value of the business tax incentives claimed by the taxpayer on the returns of the previous calendar year.

Similar provisions would be added to the Personal Income Tax Law and the Corporation Tax Law.

The bill would become operative January 1, 2012.

COMMENTS

- 1. Sponsor and Purpose.** According to the author's office, the purpose of this bill is to bring needed transparency and accountability to tax breaks given to taxpayers. The author's office notes that this bill will set clear expectations for corporations and guarantee that the state's investment will yield measurable results in the form of job retention and creation.
- 2. For sales tax purposes, this bill raises a concern.** When a retailer makes a sale that qualifies for an exemption from the sales tax, generally the retailer does not collect sales tax reimbursement from the customer on that sale. The retailer claims a deduction for the exempt sale on his or her sales tax return for the reporting period in which the sale was made. Generally, the purchaser, rather than the retailer, is the true beneficiary of a sales tax exemption.

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As an example, if the Legislature were to provide an exemption for sales of electric vehicles for the purpose of stimulating manufacturing jobs in California, a selling dealer would be the taxpayer claiming the “business tax incentive” under this bill when it sells the car to the consumer. The consumer would benefit, as would perhaps the manufacturer, and suppliers to the manufacturer, should an increase in demand for electric cars occur. However, if a dealer were to have a net decrease in full-time employees, as described in the bill, the dealer would be subject to the penalty proposed in the bill – not the manufacturer, supplier, or the consumer who may have benefited from the incentive. In fact, most sales tax exemptions benefit the purchaser, not the retailer claiming the exemption. Yet, under this bill, only the retailer would be subjected to the proposed penalty.

- 3. For use tax purposes, the bill has other concerns.** Use tax is imposed on a purchaser of tangible items, and is generally applicable to a purchase made from an out-of-state retailer. Generally, exemptions and exclusions in current law apply to both the sale and the purchase of items. If the Legislature were to provide a sales and use tax exemption for the sale and purchase of a specific item on the basis that the exemption would create jobs, under this bill, the purchaser may be the only “qualified taxpayer” that claimed the business tax incentive. If the purchaser has a net decrease in full-time employees, the bill would subject the purchaser to the proposed penalty, despite the fact that the employment numbers in the industry selling the item may have grown dramatically.

For example, if a sales and use tax exemption for sales and purchases of solar energy systems was enacted by the Legislature on the basis that such a “business tax incentive” would, among other things, create jobs in the solar energy sector, the imposition of the penalty against the purchaser may have an unintended consequence. If a California real estate developer (meeting the required employee threshold of 101) purchased a number of solar energy systems for installation in its housing project from an out-of-state retailer who was not required to collect the use tax, the developer would receive the benefit of the business tax incentive, by not remitting use tax on his or her purchase. However, even though the legislation was enacted to create jobs for the solar energy industry, and the industry’s employment figures rose dramatically, it appears a penalty would still be imposed upon the developer if the developer has a net decrease in full-time employees.

- 4. Proposed penalty under the Sales and Use Tax Law may provide an incentive for retailers to collect sales tax reimbursement instead of claiming a “business tax incentive.”** The penalty proposed in the bill would be \$5,000 for the loss of each full-time employee that exceeds the allowable net decrease described in the bill, up to the total “value of the business tax incentives claimed.” The bill would define a “business tax incentive” as a credit, deduction, exclusion, exemption, or any other tax benefit.” In the case of a sales and use tax exemption or exclusion, it appears the total “value of a business tax incentive” would be the actual sales or use tax amount associated with the business tax incentive. With a potential penalty, and the uncertainty in today’s economy as to whether or not a retailer can avoid a net decrease in full time jobs, some retailers may choose to ignore a business tax incentive and continue reimbursing themselves for the tax, despite an exemption or exclusion created by the Legislature. For struggling retailers, this could negatively impact their competitiveness with other retailers who may be in a better position to claim a business tax incentive, despite the risk of a penalty.

- 5. Language issue.** The language for the proposed penalty would specify that the penalty shall not exceed the total *value* of business tax incentives claimed by the taxpayer on the tax returns of the previous year. In order to avoid ambiguity, perhaps the language should specify that the penalty shall not exceed the amount of sales tax reimbursement or use tax that the retailer would have collected had the business tax incentive not applied.

COST ESTIMATE

Enactment of this bill would not impact the BOE's administrative costs, since the effects of the bill would occur when future business tax incentives are enacted.

REVENUE ESTIMATE

This bill would have no impact on existing state and local sales and use tax revenues, since the bill would only apply to future business tax incentives created by the Legislature.

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