

[Senate Bill 1210](#) (Gaines)

Date: Introduced

Program: Sales and Use Tax

Sponsor: Author

Revenue and Taxation Code: 6370.1

Effective: Upon Enactment, but operative 08/12/17

Michele Pielsticker (Chief) 916.322.2376

Stephanie Cochran (Analyst) 916.322.7281

Mark Durham (Revenue) 916.445.0035

**Summary:** Provides a partial sales and use tax exemption (3.9375%) on the sale of clothing, footwear, school supplies, books, computers, and educational computer software during a two-day period in August 2017, and every year thereafter, when purchased at a retailer’s physical place of business.

**Purpose:** To lessen the financial burden on parents purchasing back to school products while increasing sales for in-state retailers.

**Fiscal Impact Summary:** Annual state sales and use tax loss of \$16 million.

**Existing Law:** California’s Sales and Use Tax Law<sup>1</sup> imposes the sales tax on retailers for the privilege of selling tangible personal property at retail in this state or the use tax upon the storage, use, or other consumption of tangible personal property purchased from a retailer, unless the law provides a specific exemption or exclusion.

Under current law, sales of clothing, footwear, school supplies, books, computers, and educational computer software on a CD, are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute.

**California’s sales and use tax rates:** Effective January 1, 2017, California’s statewide sales and use tax rate will be 7.25%.<sup>2</sup> The table below shows California’s various sales and use tax rate components, that will apply as of January 1, 2017 (the table excludes voter-approved city and county district taxes):

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
1.0625%	Local Revenue Fund 2011	Realignment of local public safety services (RTC Sections 6051.15 and 6201.15)
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)
1.25%	Local (City/County) 1.00% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

**Proposed Law:** The bill adds RTC Section 6370.1 to the Sales and Use Tax Law to provide a General Fund (3.9375% rate) sales and use tax exemption for the sale of, and the storage, use, or other consumption in this state of clothing, footwear, school supplies, books, computers, and educational

<sup>1</sup> Part 1 of Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).

<sup>2</sup> The .25% tax imposed under Section 36 of Article XIII of the State Constitution (Proposition 30, The Schools and Local Public Safety Protection Act of 2012) will sunset December 31, 2016.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position

computer software on an annual basis during a two day period in August, beginning at 12:01 a.m. on the second Saturday of August and ending at 11:59 p.m. on the following day (August 12 through 13, 2017). The exempted items must be purchased at the retailer's physical place of business.

**Legislative History:** Over the years, "sales tax holiday" bills have been introduced to provide a sales tax exemption for certain types of merchandise, all of which failed to pass. The more recent bills include:

Year	Bill	Summary
2015	AB 1280 (Maienschein)	State tax exemption on tangible personal property purchased at an in-state small retailer the Saturday after Thanksgiving starting in 2016.
2013	AB 718 (Melendez)	State tax exemption on tangible personal property sold during a one-day period on April 15, 2014, and recurring on every April 15 thereafter.
2011	AB 1007 (Cook)	State tax exemption on "qualified back-to-school products," for \$100 or less, during a three day period in August 2012, and every following year until January 1, 2016.
2008	AB 1120 (Tran)	State and local tax exemption on "qualified disaster preparedness products," as specified, sold during a seven-day period in October of each year until January 1, 2012.
2006	AB 2089 (Tran)	State tax exemption on "qualified disaster preparedness products," as specified, during a nine-day period in October of each year until January 1, 2010.
2006	AB 548 (Garcia)	State and local tax exemption on any article of clothing, clothing accessories, or footwear for \$100 or less, school supplies for \$500 or less, and personal computers for \$1,000 or less, during a four-day period in August 2006.

### Commentary:

1. **Effect of the bill.** This bill would exempt the sale or use of clothing, footwear, school supplies, books, computers, and educational computer software from the 3.9375% state sales tax rate on August 12 and 13, 2017. The exemption would occur each second weekend in August, every year thereafter.
2. **Exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: (1) a rescission of the original sale and (2) a separate sale of the replacement merchandise. As an example, if a customer purchases a computer and exchanges the computer for a laptop, the transaction is regarded under the law as a separate sale of the laptop and a rescission of the original sale of the computer. To report the correct amount of tax, the retailer may deduct the sales price of the computer from taxable sales, and must include the sales price of the laptop. Under the proposed holiday period, if the same computer is purchased during the sales tax holiday period and exchanged for the laptop after the holiday period, the proposed exemption would not apply to the exchange; the law recognizes that transaction as occurring after the exempt holiday period. This complexity may lead to retailer reporting errors, added confusion and increased customer inquiries.  
  
Rain checks could also create confusion. Current law provides that a retailer-issued rain check does not constitute a sale of tangible personal property. Therefore, the exemption would not apply when a retailer issues a rain check to the customer for an out of stock item during the holiday period and the customer uses the rain check to purchase the item after the proposed holiday period.
3. **The sales tax holiday could increase retailer's costs.** Creating a sales tax exemption that only lasts for two days would place an additional burden on retailers to program their cash registers to exempt sales on certain dates. This may require retailers to incur costs to accommodate the change. Increased sales activity during this period potentially could offset those costs.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position

4. **Partial exemptions complicate administration.** Currently, most sales and use tax exemptions are applied to the total applicable sales and use tax. However, a few partial exemptions in California law only exempt the state tax portion of the sales and use tax rate, such as sales and purchases of manufacturing and research and development equipment, teleproduction equipment and farm equipment. These partial exemptions complicate return preparation and processing, and result in more errors.
5. **The definition of “school supplies” is broad.** Without a defined list of supplies, retailers may find it difficult to determine what constitutes a school supply subject to the exemption. This could lead to inconsistent application among retailers. Staff suggests providing a list of supplies that will qualify for the exemption.
6. **States with similar sales tax holidays.** Currently, fourteen states will hold a sales tax holiday in 2016: Alabama, Arkansas, Connecticut, Iowa, Louisiana, Maryland, Mississippi, Missouri, New Mexico, Oklahoma, South Carolina, Tennessee, Texas, and Virginia. Eligible items include clothing, computers, school supplies, energy star products, firearms and hunting supplies, hurricane preparedness items, and severe weather preparedness kits. For most states, the exemption applies to specified items.

**Administrative Costs:** BOE would incur costs to notify affected taxpayers, modify tax returns, revise regulations and pamphlets, answer inquiries from industry and the public, program changes, audit claimed amounts, revise sales tax returns, and review returns with claimed exemptions. In addition, because of the potential for a partial tax exemption, administrative costs would also be incurred in computer programming, return analysis, and return processing. An estimate of these costs is pending.

### **Revenue Impact:**

**Background, Methodology, and Assumptions.** Using the Bureau of Economic Analysis (BEA) data for **clothing and footwear**, and removing all electronic sales (internet), mail order, and other direct selling, the U.S. national expenditures for 2014 was approximately \$329.8 billion. California’s market share is about 12%, or \$39.6 billion. Accounting for sales growth to 2017, the estimated sales are about \$40.8 billion.

Using that same data source and methodology, the U.S. national expenditures for **books** is about \$26.5 billion, and the California share is about \$3.3 billion adjusted to 2017.

Finding information specific to **educational software** was challenging; however, staff did find 2014 data from an article “The Future of Education Technology”, by the DataFox Blog. This article indicates that U.S. purchases approximately \$8 billion of educational software for Pre K through 12th grade. Applying the 12% California share, total California expenditures equate to approximately \$960 million. Staff could not find any definitive data on how much is purchased in-store or online, therefore, staff assumes that only 15% is purchased in-store. This amounts to approximately \$144 million in taxable sales, or approximately \$149 million for 2017. In addition, this figure does not reflect post-secondary sales, and the assumption is that the majority from this sector are being purchased online and not in-stores.

BEA does not have a good breakdown for **computers**; therefore, staff used U.S. Census data. Removing those purchased at electronic stores (internet), mail order, or other direct selling, the national sales for computers was \$31.7 billion. Applying the 12% California share plus the growth rate to 2017, the total sales are \$4.1 billion.

Again, BEA does not have a good breakdown for **school supplies**, so staff used U.S. Census data. In addition, the data does not breakout school supplies versus office supplies, and staff is not sure how that will be differentiated at the point of sale. Therefore, all office and school supplies were included. Applying the same methodology as used to determine computer sales, the 2017 total sales are approximately \$1.2 billion.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position

**Total estimated sales.** Total sales of clothing and footwear, books, computers, educational software, and school supplies are estimated to be \$49.5 billion. Two days' worth of sales, taking into account an increase in sales during the two days, totals approximately \$407 million.

**Revenue Summary.** The annual revenue impact from exempting \$407 million in sales from the 3.9375% sales and use tax rate would be a \$16 million revenue loss.

**Qualifying Remarks.** This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law. It also does not account for post-secondary educational software sales.