

Amend Section 6591.5 of the Revenue and Taxation Code to revise the interest calculation provisions in the tax and fee programs the Board of Equalization (BOE) administers so that the rate of interest allowed on refunds of tax and fee overpayments is the same as that calculated on late payments.

Source: Honorable Michele Steel

Existing Law. Under existing law, persons who are late in payment of their tax, fee or surcharge (tax) obligations are required to pay a penalty of 10 percent of the tax, plus interest on those unpaid taxes from the date the tax was due to the date upon which they are paid. Interest on a late payment of tax is calculated using the Internal Revenue Service (IRS) rate pursuant to provisions of the Internal Revenue Code, plus three percent. That rate is currently seven percent.

Existing law also provides for interest to be granted to persons who have overpaid their tax or fees (when it is determined that the overpayment was not intentional or a result of carelessness). Interest on overpayments is calculated differently than it is for late payments. For overpayments, the law specifies that interest be calculated based on the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent (or if that rate is a multiple of $\frac{1}{2}$ of one percent, the rate is increased to the next highest full percent). Recently, the bond equivalent rate of 13-week treasury bills has been so low that, when rounded to the nearest full percent, the rate is actually 0 percent for purposes of the credit interest rate on overpayments. Consequently, no interest has been granted on overpayments of tax made for any period starting July 1, 2009 through today.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the BOE to taxpayers on overpayments and late payments. However, AB 2181 and SB 179 (Chs. 85 and 88, Stats. 1991, respectively) significantly changed the computation of *credit* interest on overpayments of tax. Instead of using the IRS rate plus three percent for overpayments, the law required that interest on overpayments be based on the bond equivalent rate of 13-week treasury bills auctioned – a rate that is generally six to eight percent lower. Therefore, under current law, there is significant difference in the rate of interest paid on overpayments and the rate of interest assessed on late payments.

This Proposal. This proposal would amend Revenue and Taxation Code Section 6591.5 of the Sales and Use Tax Law to specify that the rate established for interest to be paid by the state upon overpayments of tax shall be equal to the rate assessed by the BOE on late payments.

Since the various Special Taxes and Fees laws currently reference Section 6591.5, the interest on overpayments of taxes or fees under the Special Taxes and Fees programs administered by the BOE would also be calculated in accordance with this proposal.

This proposal is intended to eliminate the disparity that often becomes the subject of controversy between taxpayers and the BOE. The entire basis for the lower credit interest rate was to reduce the amount of interest associated with refunds the state was required to pay on an unfavorable court decision. Since the settlement agreement on repayment of the refunds has been finalized for years, there is simply no justification now to have the 6 to 7-point discrepancy in the credit interest rate. This proposal would put an end to this unfairness, by amending the law so that the same rate of interest is applied to both late payments as well as overpayments in all the tax and fee programs.

Background. The July 1, 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to address the budget deficit. This legislation was prompted by a 1990 landmark decision involving new sales and use tax issues for U. S. Government contractors in California. As a result of that decision, U.S. Government contractors were entitled to refunds of overpayments of taxes previously paid to the BOE on specified transactions with the U. S. Government. Because of the potentially significant amount of tax and the period of time the overpayments occurred, it was recognized that these refunds would include a very significant amount of credit interest. With the reduced rate of interest, naturally, the state would not lose such a significant amount of revenue.

Fourteen different bills to equalize the interest rates on overpayments and underpayments have been introduced since 1992. Eleven of those 14 have been sponsored by the BOE with unanimous vote of the Members, the most recent in 2011 (SB 421, Correa). However, all except for one were held either in a policy committee or appropriation committee due to the fiscal effect. One measure, introduced in 1992 (a year after the disparity was added into law), was passed by the Legislature, but vetoed by Governor Pete Wilson. In his veto message, Governor Wilson stated:

“Legislation enacted last year (Chapter 85, Statutes of 1991) established a separate, lower rate for state and local sales tax refund liability. Chapter 85 was enacted to minimize the impact of accruing interest as a result of the Aerospace decision. This bill would reverse that legislation, thereby reinstating the higher rate on refund liability.

“Imposing a lower rate for refunds minimizes the impact on the state in the event of large taxpayer refund liability. Imposing a higher rate on amounts owed by taxpayers serves as an incentive for taxpayers to remit those amounts in a timely manner as well as to comply with the law. I do not wish to change these incentives.”

The following is a listing of the various bills considered by the Legislature to address the interest rate disparity. Also, we've included a history of the interest rates since 1987.

The following is a history of bills to equalize the interest rates. Bills in **bold** were sponsored by the BOE.

Year	Legislation	Proposal	Final Status
2011	SB 421 , Correa	Equalize interest rates	Senate Governance and Finance Committee adopted amendments to reduce the interest rate on underpayments by 3%; bill was subsequently held in Senate Appropriations Committee
2008	AB 1926 , Shirley Horton	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2005	AB 1589, Villines	Equalize interest rates	Held in Assembly Appropriations Committee
2001	SB 825 , Poochigian	Equalize interest rates	Held in Senate Revenue and Taxation Committee
2000	Stats. 2000, Ch. 607 (AB 2612)	As introduced, equalize rates	Enacted to add an uncodified section that declares it is the intent of the Legislature to require that the interest rates to be the same
2000	AB 1208 , AR&T Comm.	Equalize interest rates	Provisions amended out in Senate Appropriations Committee
1999	AB 464 , Maldonado	Equalize interest rates	Held in Assembly Appropriations Committee
1997	AB 222 , Takasugi	Equalize interest rates	Amended in the Senate to increase the credit interest rate by one percent, but held in the Senate Appropriations Committee
1995	AB 397, Hannigan	Equalize interest rates	Comprehensive measure to make many significant changes to the tax laws and vetoed by Governor Wilson (interest rate provision not specifically addressed in veto message)
1995	AB 1190, Morrissey	Equalize interest rates	Provisions amended out in Assembly Revenue and Taxation Committee
1995	AB 1189 , Takasugi	Equalize interest rates	Held in the Senate Appropriations Committee
1994	AB 3487 , Andal	Equalize interest rates	Held in the Assembly Revenue and Taxation Committee
1993	AB 2083 , Takasugi	Equalize interest rates	Never heard in committee
1992	AB 2972 , Mays	Equalize interest rates	Vetoed by Governor Wilson

Board of Equalization
Interest Rates 01/01/87 through Current

From	To	Assessments	Refunds
01/01/87	09/30/87	11%	11%
10/01/87	12/31/87	13	13
01/01/88	03/31/88	14	14
04/01/88	09/30/88	13	13
10/01/88	03/31/89	14	14
04/01/89	09/30/89	15	15
10/01/89	06/30/91	14	14
07/01/91	12/31/91	14	6
01/01/92	06/30/92	13	6
07/01/92	12/31/92	12	4
01/01/93	06/30/93	11	3
07/01/93	12/31/94	10	3
01/01/95	06/30/95	11	4
07/01/95	06/30/96	12	6
07/01/96	12/31/98	12	5
01/01/99	06/30/99	11	5
07/01/99	12/31/99	10	4
01/01/00	12/31/00	11	5
01/01/01	12/31/01	12	6
01/01/02	06/30/02	10	4
07/01/02	06/30/03	9	2
07/01/03	06/30/04	8	1
07/01/04	06/30/05	7	1
07/01/05	12/31/05	8	2
01/01/06	06/30/06	9	3
07/01/06	12/31/06	10	4
01/01/07	06/30/08	11	5
07/01/08	12/31/08	10	3
01/01/09	06/30/09	8	2
07/01/09	12/31/09	8	0
01/01/10	06/30/11	7	0
07/01/11	12/31/11	6	0
01/01/12	06/30/12	7	0

Section 6591.5 of the Revenue and Taxation Code is amended to read:

6591.5. (a) ~~-(1) For interest required to be paid to the state upon underpayments of tax to the state, "modified~~ "Modified adjusted rate per annum" means the adjusted annual rate established pursuant to subdivision (c), plus three percentage points.

~~-(2) For interest required to be paid by the state upon overpayments of tax, "modified adjusted rate per annum" means the adjusted annual rate established pursuant to subdivision (d).~~

(b) "Modified adjusted rate per month, or fraction thereof" means the modified adjusted rate per annum divided by 12.

(c) ~~The rate established for interest to be paid upon underpayments of tax shall be determined in accordance with the provisions of Section 6621 of the Internal Revenue Code which establish the underpayment rate, except that: the~~

(1) The overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be equal to the underpayment rate determined under Section 6621(a)(2) of the Internal Revenue Code.

(2) The determination specified in Section 6621(b) of the Internal Revenue Code shall be modified to be determined semiannually as follows:

~~-(1)~~

(A) The rate for January shall apply for the following July 1 to December 31, inclusive.

~~-(2)~~

(B) The rate for July shall apply for the following January 1 to June 30, inclusive.

~~-(d) (1) Except as provided in paragraph (2), the rate established for interest to be paid by the state upon overpayments of tax shall be equal to the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent (or if a multiple of one-half of 1 percent, the rate shall be increased to the next highest full percent), as follows:~~

~~-(A) The bond equivalent rate of 13-week treasury bills established at the first auction held during the month of January shall apply for the following July 1 to December 31, inclusive.~~

~~-(B) The bond equivalent rate of 13-week treasury bills established at the first auction held during the month of July shall apply for the following January 1 to June 30, inclusive.~~

~~-(2) For the period July 1, 1991, through June 30, 1992, the rate to be paid by the state upon overpayments of tax shall be equal to the bond equivalent rate of 13-week treasury bills established at the auction held on July 1, 1991, rounded to the nearest full percent (or if a multiple of one-half of 1 percent, the rate shall be increased to the next highest full percent).~~

~~-(e)~~

(d) For purposes of this part, and any other provision of law referencing this method of computation, in computing the amount of any interest required to be paid by the state or by the taxpayer, or any other amount determined by reference to that amount of interest, that interest and that amount shall be computed as simple interest, not compound interest.