

Amend Section 6591.5 of the Revenue and Taxation Code to revise the interest calculation provisions in all BOE administered tax and fee programs. This proposal requires the rate of interest allowed on overpayment refunds to equal the rate of interest calculated on late payments.

Source: Honorable Michelle Steel

Existing Law. Existing law requires persons who are late paying taxes fees or surcharges (collectively “taxes”) to pay a penalty of 10% of the tax, plus interest on the unpaid liability from the tax due to the last day of the payment month. The BOE calculates interest on a late payment based on the Internal Revenue Service (IRS) rate under the Internal Revenue Code, plus 3%. That rate currently is 6%.

Existing law also allows the BOE to grant credit interest on tax overpayments when it determines that the overpayment was not intentional or due to carelessness. Interest is calculated differently on overpayments than for late payments. For overpayments, the law specifies that interest is computed based on the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent.¹ 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 zero percent. Consequently, the BOE has not granted interest on tax overpayments since July 1, 2009.

Before July 1, 1991, the same rates of interest applied on overpayments and late payments. However, AB 2181² and SB 179³ changed the computation of *credit* interest on tax overpayments. Instead of the IRS rate plus 3%, the law requires interest on overpayments to be the bond equivalent rate of 13-week treasury bills auctioned – a rate generally 6-8% lower. Therefore, under current law, the interest rate on overpayments is significantly lower than the interest rate charged on late payments.

This Proposal. This proposal amends Revenue and Taxation Code Section 6591.5 of the Sales and Use Tax Law to specify that the interest rate on tax overpayments is equal to the interest rate on late payments.

Because the various special tax and fee laws currently reference Section 6591.5 for purposes of the applicable overpayment interest rate, this proposal also applies to those programs.

Background. Due to an unfavorable decision in *Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300, the Department of Finance proposed the idea of a revised method for computing overpayment interest. The court decision involved new sales and use tax issues for U. S. Government contractors in California and resulted in BOE tax refunds related to specified U.S.

¹ If that rate is a multiple of ½ of 1 %, the rate increases to the next highest full percent.

² Chapter 85, Stats. 1991.

³ Chapter 88, Stats. 1991.

Government transactions. The potentially significant revenue loss resulting from interest on those tax refunds prompted this change.

This proposal places taxpayers and the BOE on a level playing field with respect to interest. Under the proposed law, the same interest rate applies to both late payments and overpayments in the various tax and fee programs the BOE administers.⁴ Because the BOE processed all applicable refunds years ago, retaining the 6 to 8-point interest rate disparity is no longer justified.

Since 1992, fifteen different bills to provide equal interest rates on overpayments and late payments have been introduced. The BOE voted unanimously to sponsor 12 of those 15 measures, the most recent in 2012 (AB 2048, Donnelly). However, either the policy committee or fiscal committee held all except for one due to the fiscal effect. The Legislature approved one 1992 measure one year after the interest disparity was enacted, but Governor Pete Wilson vetoed the legislation. 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 table provides the legislative history of the various measures that previously have addressed the interest rate disparity. Also, we have included a history of the BOE interest rates since 1987, followed by information on the current interest rates applied in other states.

⁴ All programs administered by the BOE are subject to RTC Section 6591.5 except the Timber Yield Tax. The interest rate specified in the Timber Yield Tax Law (sections 38451 and 38606) is the same for overpayments and late payments, and is based on Section 19521 of the Revenue and Taxation Code. That rate is 3 percent currently, and is computed on a daily basis.

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

Year	Legislation	Proposal	Final Status
2012	AB 2048 , Donnelly	Equalize interest rates	Held in Assembly Appropriations Committee
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 the intent of the Legislature that the interest rates 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 1%, 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
07/01/12	06/30/13	6	0

Other States' Interest Rates

The states surveyed include *Arizona, Florida, Illinois, Massachusetts, Michigan, Minnesota, Nevada, New York, Texas and Utah*. These states were selected for their geographic proximity to California and similarity to California's economy, legal entity structure, and tax laws. The rates may change quarterly, annually, or according to some other period. The rates cited below were obtained from each state's Internet sites.

Arizona applies the Federal short-term rate (currently 0%) plus 3% for both overpayments and late payments. If an originally filed return shows that the taxpayer is entitled to a refund, no interest is allowed if the refund is paid within 60 days of the return's due date or 60 days from the filing of the return, whichever is later.

Florida has a 7% interest rate on late payments and overpayments of most taxes and fees (including sales and use tax). Generally, interest begins to accrue on overpayments on the 91st day after the Department receives a completed application for refund. Interest may not exceed 11%.

Illinois uses the "short term federal rate" for the first year - currently 0% for both late payments and overpayments. After one year, interest accrues on any remaining balance at the "underpayment rate" of 3%.

Massachusetts uses the Federal short-term rate, plus 4%, compounded daily for late payments. For overpayments, it uses the Federal short-term rate plus 2%, simple interest.

Michigan applies a 4.25% interest rate to late payments and overpayments (based on the "adjusted prime rate" charged by three commercial banks to large businesses, plus 1%).

Minnesota imposes interest at a 3% rate on both late payments and overpayments.

Nevada uses a 9% interest rate on late payments and a 3% rate on overpayments.

New York compounds interest daily, and provides a 14.5% interest rate on late payments under the Sales and Use Tax Program (7.5% under the income tax and most other tax and fee programs) and a 2% rate on overpayments. If the Commissioner determines that the failure to timely pay is due to reasonable cause, the Commissioner may impose interest at the corporation tax late payment rate of 7.5%.

Texas applies an interest rate of 4.25% on late payments beginning 61 days after the due date. The late payment interest is computed on a simple, daily basis (the rate is calculated based on 1% over the prime rate as published in the *Wall Street Journal* on the first business day of the year). Interest on overpayments is also 4.25% (based on the Treasury Pool rate or Prime +1, whichever is less).

Utah uses a 2% interest rate on late payments and overpayments of taxes and fees (the calendar-year simple interest rate is 2% above the federal short-term rate).

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.