California State Board of Equalization,
Legislative and Research Division

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State Capitol Building (from the East) c.1945
Photo courtesy of California State Archives

SALES TAX LEGISLATION
2009

SALES TAX LEGISLATION
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Assembly Bill 129 (Ma) Chapter 411

Confidentiality: Taxpayer Communications

Urgency measure, effective October 11, 2009. Among its provisions, adds Section 7099.1 to the Revenue and Taxation Code.

BILL SUMMARY

This bill, among other things unrelated to the Board, reinstates the provisions related to tax practitioner-client confidentiality privilege that sunset on January 1, 2009.

Sponsor: California Society of Enrolled Agents

LAW PRIOR TO AMENDMENT

Under current law, confidential communications between a client and an attorney are protected from disclosure to third parties, under certain circumstances (Evidence Code Sections 950 – 962). Under the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998, the attorney-client privilege is extended to tax advice, as defined, that is furnished to a client-taxpayer by any individual who is authorized to practice before the IRS as well as any federal court, if the IRS is a party to the proceeding.

Up until January 1, 2009, Revenue and Tax Code Section 7099.1 of the Sales and Use Tax Law conformed to the federal provisions by extending similar tax practitioner-client confidentiality privileges. California law provided that with respect to tax advice, certain protections of confidentiality that apply to a communication between a client and an attorney shall also apply to a communication between a taxpayer and any federally-authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a client and an attorney. The term "federally authorized tax practitioner" meant any individual authorized under federal law to practice before the IRS if the practice is subject to regulation. These individuals included attorneys, certified public accountants, enrolled agents, and enrolled actuaries who are required to abide by the Standards of Ethical Conduct as published in U.S. Treasury Department Circular 230. “Tax advice” was defined as advice given by an individual with respect to a matter that is within the scope of the individual’s authority to practice. The confidentiality protection only applied to the extent that the communication would have been considered a privileged communication if it had been between a client and an attorney, and only in non-criminal tax matters before the specified state agencies. The privilege did not apply to any written communication between a federally-authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of that corporation in any tax shelter, or in any proceeding to revoke or otherwise discipline any license or right to practice by any governmental agency.

These provisions sunset on January 1, 2009.

AMENDMENT

Among other things, this bill reinstates Section 7099.1 in the Sales and Use Tax Law to incorporate the tax practitioner-client confidentiality privilege indefinitely.

The bill became effective October 11, 2009.

BACKGROUND

Assembly Bill 1016 (Ch. 438, Stats. 2000), added the tax practitioner-client privilege to current law. That bill contained a sunset date of January 1, 2005, and AB 1416 (Ch. 412, Stats. 2004) extended the sunset date to January 1, 2009.

COMMENTS

1. **Purpose.** To reinstate the tax practitioner-client privilege that inadvertently sunset.
2. **Amendments.** The **May 4, 2009 amendments** specified that a federally authorized tax practitioner has the legal obligation and duty to maintain confidentiality with respect to tax-practitioner-client communications. Subsequent amendments were all technical and nonsubstantive.
3. **The proposed privilege is no broader than the attorney/client privilege, would only apply to non-criminal proceedings, and affords certified public accountants and enrolled agents the same privilege that is extended to attorneys when discussing similar issues.** The trend toward attorneys joining accounting firms has blurred the distinction between legal advice and guidance provided by accountants. This bill makes that distinction insignificant with respect to confidentiality privileges.
4. **Since enactment of these provisions, there has been no adverse impact on Board proceedings.** Although there was at least once instance where, prior to enactment of this original provision in 2000, a taxpayer could have successfully prevented the Board from viewing a letter at a Board hearing, which may have precluded the imposition of fraud and failure to file penalties, there has not been any adverse impact on Board proceedings since these provisions were first added to the law in 2000.

Assembly Bill 1486 (Furutani) Chapter 538

Nonprofit Organizations' Promotional Items

Effective October 11, 2009, but operative April 1, 2010. Adds and repeals Section 6018.9 of the Revenue and Taxation Code.

BILL SUMMARY

This bill provides that, until January 1, 2015, specified nonprofit organizations will be regarded as consumers, rather than retailers, of certain sales of tangible personal property to the organizations' members, under specified conditions.

Sponsor: California State Council of Laborers

LAW PRIOR TO AMENDMENT

Under California's Sales and Use Tax Law (Part 1, Division 2 of the Revenue and Taxation Code, commencing with Section 6001), except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. Under the law, sales tax is imposed on a retailer's gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt from taxation by statute. This tax is imposed on the retailer who may collect reimbursement from the customer if the contract of sale so provides. The Sales and Use Tax Law provides no general statutory exemption from the sales or use tax merely because the seller or the purchaser is engaged in charitable activities, is a nonprofit organization, or enjoys certain privileges under property tax statutes or income tax statutes.

Under the law, every retailer or any other person that makes three or more retail sales of tangible personal property of a kind the retail sale of which is taxable in this state is required to obtain a seller's permit and report the tax on his or her sales on a return prescribed by the Board. However, California's Sales and Use Tax Law places a variety of retailers making taxable sales of tangible personal property under a "consumer" reporting status. Under a "consumer" reporting status, a qualifying retailer making otherwise taxable sales is not required to obtain a seller's permit or report tax on those sales. Rather, the qualifying retailer is only required to pay tax on his or her cost of the taxable components of the products he or she sells.

The "consumer" reporting status is primarily intended to minimize reporting burdens placed on smaller businesses and entities, while minimizing the associated revenue loss that can accompany a complete exemption from the tax. The law has extended this consumer reporting status to certain sales by such entities as nonprofit youth groups, PTAs, nonprofit veterans' organizations, various charitable organizations, schools and school districts, optometrists, veterinarians, podiatrists, licensed hearing aid dispensers, and others with respect to certain products they sell.

AMENDMENT

This bill adds Section 6018.9 to the Sales and Use Tax Law to specify that, until January 1, 2015, an organization described in Section 501(c) of the Internal Revenue Code is a consumer of, and shall not be considered a retailer for purposes of any transfer of tangible personal property to its members, as defined, if the following requirements are met:

1. The tangible personal property bears a logo or other identifying mark of the organization and is a promotional item or other item commonly associated with use by a member to demonstrate the member's association with, or membership in, the organization.
2. The cost to the member of the organization for the acquisition of the tangible personal property is not more than the cost to the nonprofit organization to obtain and transfer to the member the tangible personal property, including any applicable sales or use tax paid by the nonprofit organization.
3. Reasonable steps are taken by the organization to ensure that no member is allowed to acquire more than 30 identical items of tangible personal property or to resell the items to another person.
4. The tangible personal property is not distributed for purposes of political campaigning or issue advocacy.

The bill defines "member" by reference to Corporations Code Section 5056.

The bill becomes operative on April 1, 2010, which is the first day of the first calendar quarter commencing more than 90 days from the bill's effective date.

COMMENTS

1. **Purpose.** To relieve nonprofit organizations from the burdensome and time-consuming task of maintaining records and filing sales tax returns for their sales of promotional items to members, when the sales prices of those promotional items are no more than the price paid by the organization.
2. **Amendments.** The **July 14, 2009 amendments** specified that the tangible personal property may not be distributed for purposes of political campaigning or issue advocacy. These amendments were requested by the Senate Revenue and Taxation Committee to address an issue brought up in the prior Board staff analysis.
3. **Amendments still raise administrative issues.** The amendment that specified that the property may not be distributed for purposes of political campaigning or issue advocacy continues to leave some uncertainty. This provision could be interpreted to mean that any item containing a logo of a nonprofit organization that advocates issues could be considered distributed for purposes of issue advocacy. For example, would purchases of t-shirts or hats containing such logos as SPCA, MADD, or the NRA, etc. that are distributed to members at cost be excluded?
4. **This bill only applies to promotional items sold at cost.** As long as a nonprofit organization only makes sales of tangible personal property described in the bill, then the nonprofit organization will not need to possess a seller's permit, file sales tax returns, or remit sales tax on those sales. However, if a nonprofit organization makes any other sales of tangible personal property, or sells the promotional items even

slightly above its purchase price, they would still be required to file sales tax returns and maintain records to report the proper amount of tax.

Assembly Bill 1547 (Committee on Revenue and Taxation) Chapter 545

Reinstatement Fee Increase
Vehicles, Vessels, and Aircraft

Effective January 1, 2010. Among its provisions, amends Sections 6069 and 6248 of the Revenue and Taxation Code.

BILL SUMMARY

This Board-sponsored bill makes the following changes to the sales and use tax program:

- Increases the reinstatement fee on revoked seller's permits from $50 to $100.
- Clarifies the definition of "California resident" and the exception for repair, retrofit, and modification for purposes of the 12-month test for out-of-state purchases of a vehicles, vessels and aircraft.

Sponsor: Board of Equalization

Reinstatement Fee Increase
Revenue and Taxation Code Section 6069

LAW PRIOR TO AMENDMENT

Under existing Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax is required to apply to the Board for a seller's permit. There is no fee charged for a seller's permit. Whenever a person that has obtained a seller's permit fails to comply with any of the provisions of the law under which that permit is held, existing law authorizes the Board, upon hearing for which 10 days notice has been given, to revoke the permit.

Cause for revocation may be due to a taxpayer's failure to file returns and pay the tax, failure to pay a delinquent balance, failure to post the required security, failure to keep or make available proper records, or for violation of any provision of the Sales and Use Tax Law. Under the law, a seller whose permit has been revoked for failure to comply with the law is required to pay a fee of fifty dollars ($50) to reinstate the permit.

AMENDMENT

This provision increases the reinstatement fee for revoked permits from $50 to $100.

COMMENT

Purpose. This provision is intended to both encourage taxpayer compliance with regard to the timely filing of returns and payment of sales and use tax liabilities as well as to defray the Board's costs associated with revoking and reinstating seller's permits. This reinstatement fee was first added to the law in 1941 and was set at $1. The fee was increased in 1966 to $15, and the Board sponsored legislation in 1986 to increase the fee to $50. Due to the rate of inflation since 1986, the equivalent reinstatement fee would be about $95 today. Therefore the $100 change is consistent with the rate of inflation since the last increase.

VEHICLES, VESSELS AND AIRCRAFT
Revenue and Taxation Code Section 6248

LAW PRIOR TO AMENDMENT

The approval of the 2008-2009 California Budget included the enactment of AB 1452 (Stats 2008, Chapter 763, effective September 30, 2008), which in part amended Revenue and Taxation Code Section 6248 of the Sales and Use Tax Law. The amendments permanently replaced the "90-day test" with a "12-month test" for determining whether an out-of-state purchase of a vehicle, vessel, or aircraft was for the purpose of storage, use, or other consumption in California and subject to California use tax. This "12-month test" was also operative during the period from October 2, 2004, through June 30, 2007.

This 12-month test essentially provides that within 12 months from the date of purchase, a vehicle, vessel or aircraft purchased outside this state and then brought into California is presumed to be acquired for storage, use, or other consumption in California and subject to tax if any of the following occurred:

1. The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the California Vehicle Code, or
2. In the case of a vehicle, the vehicle was subject to vehicle registration in California during the first twelve months of ownership, or
3. In the case of an aircraft or vessel, the aircraft or vessel was subject to property tax in California during the first twelve months of ownership, or
4. If purchased by an out-of-state resident, the vehicle, vessel, or aircraft is used or stored in this state more than one-half of the time during the first 12 months of ownership.

Under these provisions, however, the law provides that an aircraft or vessel will not be deemed to have been purchased for use in this state if that aircraft or vessel was brought into this state during the first 12 months of ownership for the purpose of repair, retrofit, or modification of the aircraft or vessel, provided that no more than 25 hours of airtime or sailing time were logged for that purpose, as specified. Additionally, the law provides that a vehicle brought into this state within the first 12 months of ownership for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less, as specified, would also not be deemed to be purchased for use in this state.

AMENDMENT

This bill, among other things, provides that it shall be rebuttably presumed that, except as specified, a vehicle, vessel, or aircraft purchased outside this state and brought into California within 12 months from the date of purchase is purchased for use in California and is subject to California use tax.

These changes to Section 6248 will close two loopholes that surfaced when the Board administered the 12-month test provisions in 2004 through 2007, and that Board staff anticipates will resurface now that the 12-month test provisions have been made permanent.

Limited Liability Companies. With respect to the first loophole, under the 12-month test language, out-of-state residents are required to show only that the vehicle, vessel or aircraft was outside California more than six months during the first 12 months of ownership. This encouraged many California purchasers to set up shell corporations and limited liability companies in other states so that they would not be considered California residents, and would only be subjected to the six-month test, rather than the 12 month test that is applied to California residents. Therefore, this provision clarifies that a California resident shall include closely held corporations and limited liability companies when 50% or more of their membership interests is held by shareholders or members who are California residents.

These new schemes for avoiding tax on purchases of recreational vehicles were highlighted in an article in a September 25, 2006, issue of the Los Angeles Times, "Under A Big Sky, They Turn RVs Into Dodges." This article reported, "Montana has no sales tax, and recreational-vehicle aficionados are taking a break from their road maps and AAA Trip-Tiks to set up shell corporations in the state…Most states make it difficult for nonresidents to get license plates. But Montana lets out-of-staters register vehicles if they own a local limited liability corporation. Setting one up merely requires some simple paperwork and about $1300 to cover incorporation costs, registration fees and attorney hours."

By setting up a limited liability company in Montana to own an RV, California residents could not only take advantage of Montana's lower vehicle registration fees, but when they brought their RV's into California, they believed that their purchases were not subject to the same presumptions regarding whether or not the vehicles were purchased for use in California as vehicle purchases by other California residents.

The staff received information that showed that approximately 900 vehicles were registered in Montana by Montana limited liability companies that appear to be closely held by California residents. Estimated taxable measure for these 900 vehicles is $227 million with tax of $16.5 million. The Los Angeles Times article, Under a Big Sky…, reported that based on comparisons of Montana vehicle records with California addresses, officials at the California Attorney General's office indicated that they believe as many as 10,000 Californians have put Montana plates on their motor homes in recent years, costing the State over $160 million for "this particular type of fraud."

For vessel purchases, it appears that many California residents are establishing limited liability companies or corporations in Oregon to show an Oregon address for their vessels. The Board's Consumer Use Tax Section has identified a recurring Oregon address for the agent of record claiming exemption for transfers of vessels to a commencing corporation. As of October 2008, the Oregon Secretary of State's database indicated that 2,103 transfers were registered in Oregon by this agent. Of those, 1,478 have been identified as limited liability companies connected to California through the address identified as the principal place of business, the mailing address, or the address for the members.

Repairs. With regard to the second loophole, the law makes an exception for repair, retrofit, and modification so that if a California resident brings a vehicle, vessel or aircraft into California during the 12-month test period solely for those services, the 12-month out-of-state usage requirement to avoid the tax wouldn't be violated. This provision clarifies that repair, retrofit and modification must be performed by a licensed repair facility in order to qualify for the exception.

The repair, retrofit and modification exception was included in law so that California businesses that service vehicles, vessels and aircraft would not be harmed economically. The abuses of this exception with aircraft were minor since the FAA requires that aircraft maintenance and modification be performed or inspected by an FAA certified repair facility. However, this exception was widely abused by vessel owners. Many vessel owners were constantly changing or repairing items on their vessels, and many vessels in California were used regularly without leaving their moorage. Board staff has had many cases in which a taxpayer regularly purchased minor parts or accessories for self-performed repair or modification over an extended period of time without ever sailing the vessel, and while keeping and using the vessel in California for purposes other than sailing. In one case, a taxpayer even lived on board the vessel while self-performing repairs and modification, but asserted that since the vessel was not sailed for more than 25 hours, the vessel was not taxable under the law.

COMMENT

Purpose. These proposed changes are intended to preserve the legislative desire to minimize the impact of the 12-month test on California businesses in the industry, while clarifying that the exception was not provided as a method of tax avoidance.

Assembly Bill 3 (Committee on Revenue and Taxation)
Chapter 18, Third Extraordinary Session

Temporary Sales and Use Tax Rate Increase

Urgency measure, effective February 20, 2009. Among its provisions, adds Sections 6051.7 and 6201.7 to the Revenue and Taxation Code.

BILL SUMMARY

This bill implements various tax provisions related to the 2009-10 Special Session budget agreement. Among other things, this bill increases the state sales and use tax rate by 1 percent beginning April 1, 2009. These provisions will sunset on July 1, 2011.

Sponsor: Budget Committees

LAW PRIOR TO AMENDMENT

Under current law, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6.25 percent is the state portion and 1 percent is the local portion. The components of the state sales and use tax rate are as follows:

- 5 percent state tax allocated to the state's General Fund (Sections 6051, 6051.3, 6201, and 6201.3)
- 0.25 percent state tax allocated to the Fiscal Recovery Fund (Section 6051.5 and 6201.5)
- 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Section 6051.2 and 6201.2)
- 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

In addition to the state portion of sales use tax rate, the following local taxes are imposed by cities and/or counties and are administered by the Board:

- 1 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- Transactions and Use Tax levied at varying rates from 0.10 to 1 percent by some cities, counties, and special taxing jurisdictions in various cities and counties within the state and which are distributed to those local agencies (Parts 1.6 and 1.7, commencing with Section 7251).

AMENDMENT

This bill adds Sections 6051.7 and 6201.7 to the Revenue and Taxation Code to impose a state sales and use tax at a rate of 1 percent.

This bill is an urgency measure and became effective immediately. However, the sales and use tax rate increase became operative on April 1, 2009.

The provisions will sunset on July 1, 2011.

BACKGROUND

California's last state sales and use tax increase occurred in July 1991 with the enactment of AB 2181 (Ch. 85, Stats. 1991). The rate was increased by 1.25 percent in response to the budget shortfall.

Prior to that increase, for a 13-month period beginning December 1, 1989 and ending December 31, 1990, a 0.25 percent state sales and use tax increase was enacted in response to the October 17, 1989 earthquake (commonly referred to as the Loma Prieta earthquake) in the San Francisco Bay Area (SB 33x, Ch. 14x, Stats. 1990, First Extraordinary Session).

Other recent measures related to the state sales and use tax rate include Assembly Bill x1 7 and Assembly Bill x5 9. ABx1 7 (Ch. 13, Stats. 2003) would have increased the state tax rate by 0.5 percent along with a corresponding decrease of 0.5 percent in the local tax rate as of July 1, 2004. However, these provisions were superseded by the passage of Proposition 57 (ABx5 9) in the March 2004 Primary Election, which increased the state tax rate by 0.25 percent along with a corresponding decrease of 0.25 percent in the local tax rate, as of July 1, 2004.

COMMENTS

1. **Purpose.** To provide the statutory changes necessary to implement the 2009-10 Special Session Budget agreement to address the fiscal emergency declared by the Governor by proclamation December 19, 2008, pursuant to subdivision (f) of Section 10 of Article IV of the California Constitution.

2. **Fixed-price contracts and fixed-priced taxable lease agreements entered into prior to April 1, 2009.** The bill's provisions do not exempt fixed-price contracts or fixed priced taxable leases from the 1 percent rate increase. Consequently, the tax rate increase applies to such contracts and leases.

3. **Impact of rate change on the Board.** Tax rate changes historically have had a significant effect on the Board. However, this impact is minimized when the rate change takes place on the first day of a calendar quarter and when the Board has sufficient lead time (at least 90 days) prior to the rate change. Since the tax rate increase becomes operative on April 1, 2009, the Board will have sufficient lead time to properly inform the public and prepare revised publications and tax returns.

4. **This bill should contain a specific appropriation to the Board.** This bill proposes a sales and use tax rate increase that takes effect April 1, 2009, which is in the middle of the state's fiscal year. An adequate appropriation is required to cover the Board's costs incurred in administering the tax rate change that is not be identified in the Board's 2008-09 Budget.

5. **Partial tax exemptions apply to the proposed 1 percent state sales and use tax.** There are five partial sales and use tax exemptions: (1) farm equipment and machinery, (2) timber harvesting equipment and machinery, (3) diesel fuel used in farming activities and food processing, (4) racehorse breeding stock, and (5) property used in teleproduction and post production activities. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to

taxes levied pursuant to Sections 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax). Therefore, the partial tax exemption statutes only apply to the state General Fund portion of the sales and use tax rate.

As of July 1, 2004, the state rate subject to the partial exemptions was 5.25 percent. When the proposed 1 percent increase becomes law, the state rate subject to the partial exemptions will be 6.25 percent.

6. **The 1 percent state sales and use tax is not included in the calculation of the sales tax prepayment rate on motor vehicle fuel, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after the removal from the terminal rack. The Board determines the sales tax prepayment rates on these fuels. The rate of prepayment is based on 80 percent of the combined state and local sales tax rate on the average selling price of the fuel as specified in industry publications.

   Effective January 1, 2009, the prepayment rates for motor vehicle fuel is $0.12 per gallon, diesel fuel is $0.135 per gallon, and aircraft jet fuel is $0.105 per gallon. These rates are scheduled to remain in effect through March 31, 2010. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailers' sales tax liability, the Board may adjust the prepayment rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

   Section 6480.1 requires the Board to establish the sales tax prepayment rates. The specific language in the statutes provides that "the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established pursuant to Section 6051, 6051.2, 6051.3, 6051.5, 7202, and 7203.1 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report."

   Because Section 6480.1 includes the code sections of each state and local tax component, the proposed 1 percent would need to be added to Section 6480.1. Without this amendment to Section 6480.1, the prepayment rate would not take into account the additional 1 percent rate resulting in lower than normally required prepayment amounts.

Assembly Bill 12 (Evans) Chapter 12, Fourth Extraordinary Session

Cost Allocation Model

Urgency measure, effective July 28, 2009. Among its provisions, amends Sections 7204.3 and 7273 of the Revenue and Taxation Code.

BILL SUMMARY

Among its provisions, this 2009-10 Budget revision trailer bill excludes revenues attributable to the temporary 1 percent state sales and use tax rate increase from the cost-allocation methodology used by the Board to allocate its administrative costs.

Sponsor: Budget Committees

LAW PRIOR TO AMENDMENT

The Board collects sales and use taxes that provide revenue for state government and essential funding for cities, counties, and special districts. The current statewide base sales and use tax rate is 8.25 percent. The following table provides the components of the state and local sales and use tax rate:

Rate	Jurisdiction	Purpose/Authority
5.00%	State (General Fund)	Dedicated for state general purposes (Sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (RTC))
[1]1.00%	State (General Fund)	Dedicated for state general purposes (Sections 6051.7 and 6201.7 of the RTC, operative 4/1/09)
0.25%	State (Fiscal Recovery Fund)	Dedicated to the repayment of the Economic Recovery Bonds (Sections 6051.5 and 6201.5 of the RTC, operative 7/1/04)
0.50%	State (Local Revenue Fund)	Dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the RTC)
0.50%	State (Local Public Safety Fund)	Dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	Dedicated to city and county general operations; Dedicated to county transportation purposes (Section 7203.1 of the RTC, operative 7/1/04)
8.25%	Total Statewide Base Rate	

Cost-Allocation Model. The Board charges the State, local governments, and local jurisdictions a fee for administering the state and local sales and use taxes on their behalf. Section 7204.3 of the Bradley-Burns Uniform Local Sales and Use Tax Law

[1] Effective April 1, 2009, ABx3 3 (Chapter 18 of the Third Extraordinary Session, signed by Governor Schwarzenegger on February 20, 2009) temporarily increases the state sales and use tax rate by 1 percent. The 1 percent tax rate increase will expire on July 1, 2011.

requires the Board to charge a city, city and county, county, or redevelopment agency (hereinafter referred to as Bradley-Burns entities), an amount for the Board's services in administering the local sales and use tax ordinance. Section 7273 of the Transactions and Use Tax Law requires the Board to charge an amount for its administration of the local transactions and use tax ordinance of each special taxing jurisdiction (STJ).

Under these statutes, the Board also is required to use a model for allocating its costs that is based on the methodology described in Alternative 4C of the November 2004 report by the Board entitled "Response to the Supplemental Report of the 2004 Budget Act." AB 1809 (Chapter 49, Stats. 2006, Committee on Budget) amended Sections 7204.3 and 7273 to require the Board to allocate its administrative costs among the State, Bradley-Burns entities, and STJs based on this methodology.

The new methodology (referred to as the "modified revenue" model) utilizes the four sales and use tax program elements as reflected in the approved Governor's Budget. Those elements are Audit, Collections, Registration and Returns. Although the cost of the Returns element is allocated between the state and local entities based on a workload approach, the other three elements are allocated based on revenue associated with those elements.

Because the methodology uses a revenue approach, when the state sales and use tax rate increased, with no change to the Board's budget, this resulted in a larger General Fund revenue share, which caused the General Fund to pay a higher amount of the existing cost of the sales and use tax program.

AMENDMENT

This bill amends Sections 7204.3 and 7273 to, beginning with the 2008-09 fiscal year through the 2014-15 fiscal year, inclusive, provide that amounts determined in accordance with the cost-allocation methodology described in Alternative 4C of the November 2004 report by the Board entitled "Response to the Supplemental Report of the 2004 Budget Act" shall not include any revenues collected pursuant to Sections 6051.7 and 6201.7.

COMMENTS

1. **Purpose.** As part of the 2009 Budget Act, the Legislative Analyst's Office recommended the enactment of legislation to provide an exception to the existing statutory cost-allocation model used by the Board to allocate its sales and use tax administrative costs. The exception prevents a shift of $6.4 million of previous existing administrative costs from Bradley-Burns entities and STJs to the General Fund that without statutory change would occur due to the larger revenue share that the General Fund temporarily receives (Effective April 1, 2009, the state General Fund portion of sales and use tax rate increased by 1 percent).

2. **Impact of the bill's provisions.** AB 3 (Chapter 18 of the Third Extraordinary Session) temporarily increases the General Fund portion of the state sales and use tax by 1 percent. Even though the state rate was increased, the Board did not receive additional administrative cost reimbursements. Therefore, since the current cost-allocation model allocates most of the Board's administrative costs using a revenue approach, this legislation is needed to maintain current funding levels. Without this legislation, the Board's funding by the General Fund would need to be augmented by

$6.4 million, with an offsetting $6.4 million decrease in the Board's local reimbursement level (Bradley-Burns entities and STJs).

Assembly Bill 18 (Budget Committee)
Chapter 16, Fourth Extraordinary Session

Use Tax Registration

Effective October 23, 2009. Among its provisions, adds Section 6225 to the Revenue and Taxation Code.

BILL SUMMARY

Among other things, this 2009-10 Budget revision trailer bill requires a qualified purchaser, as defined, to register with the Board and report and pay by April 15, the use tax owed for the previous calendar year.

Sponsor: Budget Committee

LAW PRIOR TO AMENDMENT

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code imposes a use tax 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 and is required to be remitted to the Board on or before the last day of the month following the quarterly period in which the purchase was made, or on the purchaser's state income tax return filed with the Franchise Tax Board. Generally, a use tax liability occurs when a California consumer or business purchases tangible items for their own use from an out-of-state retailer that is not registered with the Board to collect the California use tax.

AMENDMENT

This bill adds Section 6225 to the Revenue and Taxation Code to require "qualified purchasers" to register with the Board and report and pay by April 15, the use tax owed for purchases made during the calendar year. The bill defines "qualified purchaser" as a person that meets all of the following conditions:

(1) The person is not required to hold a seller's permit.

(2) The person is not required to be registered pursuant to Section 6226.

(3) The person is not a holder of a use tax direct payment permit as described in Section 7051.3.

(4) The person receives at least one hundred thousand dollars ($100,000) in gross receipts from business operations per calendar year.

(5) The person is not otherwise registered with the Board to report use tax.

These provisions became operative on October 23, 2009.

IN GENERAL

In 1933, California enacted its first retail sales tax. Within a few years of the adoption of the sales tax, California retailers believed they were facing unfavorable competition from retailers in states that had not adopted a sales tax. Customers could choose to go to a neighboring state without a sales tax and avoid paying the tax on their purchases. California responded to this challenge in 1935 by adopting a use tax. The use tax is virtually identical to the sales tax, except it is imposed on the storage, use or consumption of the goods; and the tax is imposed on the sales price of the good. The intent of a use tax is to offset the incentive to purchase from retailers in other states with low sales tax rates or no sales tax.

Although every state that has a sales tax imposes the use tax, there has been limited success in collecting the use tax. Unlike the retail sales tax that requires in-state retailers to collect the tax, states have been unable to impose a similar compliance and collection requirement on out-of-state retailers (an out-of-state retailer is required to have physical presence in a state in order to require that retailer to collect the use tax).

Therefore, California must rely on purchasers to report their use tax obligations on their out-of-state purchases, such as those made over the Internet or through mail order. And, even though a separate line is currently on the state income tax return with accompanying instructions in the booklet for use tax reporting, the compliance rate remains very low. Unreported use tax is the largest area of noncompliance in California's sales and use tax program - an estimated $1.2 billion annually is attributable to unreported California use tax by both businesses and individual consumers. For 2008, the Franchise Tax Board processed over 18.5 million returns, yet only 44,114 state income tax returns had use tax reported yielding only $9 million in state and local use tax revenues.

COMMENTS

1. **Entities that would be affected.** This bill essentially applies to all businesses that are not already registered with the Board that have annual gross receipts from business operations in excess of $100,000. We anticipate approximately 200,000 businesses fall under this measure's parameters.

2. **Bill applies to purchases made during calendar year beginning 2009.** Since the bill becomes effective immediately, returns for the reporting of use tax on untaxed purchases made during calendar year 2009 will be due by April 15, 2010. Consequently, without any advance notice of this provision, some businesses may not have kept track of their purchases subject to use tax in their records. Those businesses may have difficulty in accurately determining their correct use tax liability.

3. **Related Legislation.** AB 469 (Eng), sponsored by the Board, would *require* consumers (including businesses not already registered with the Board, such as those described in this measure) who have failed to report use tax to the Board on their taxable purchases for the preceding year to report the use tax on the income tax returns for the taxable year in which the liability for the qualified use tax was incurred, as specified. AB 469 was vetoed by the Governor.

Senate Bill 27 (Hancock) Chapter 4

Local Tax Agreements

Urgency measure, effective June 5, 2009. Adds Section 53084.5 to the Government Code.

BILL SUMMARY

This bill prohibits a local agency from entering into an agreement that results in the payment, transfer, diversion, or rebate of any Bradley-Burns local tax proceeds when the agreement results in the reduction of Bradley-Burns tax proceeds received by another local agency from a retailer, and that retailer continues to maintain a physical presence within the jurisdiction of the originating local agency, with specified exceptions.

Sponsor: City of Livermore

LAW PRIOR TO AMENDMENT

The Board administers the Bradley-Burns Uniform Local Sales and Use Tax Law (Bradley-Burns Law) which authorizes counties to impose a local sales and use tax of 1 percent on tangible personal property sold at retail in the county, or purchased outside the county for use in the county.[2] All counties within California have adopted ordinances under the terms of the Bradley-Burns Law and levy the 1 percent local tax.

Cities are authorized to impose a local sales and use tax rate of up to 0.75 percent. The city sales and use tax rate is credited against the county rate so that the combined rate does not exceed 1 percent.

Of the 1 percent, cities and counties use the 0.75 percent to support general operations. The remaining 0.25 percent is designated by statute for county transportation purposes and may be used for road maintenance or the operation of transit systems. The counties receive the 0.25 percent tax for transportation purposes regardless of whether the sale occurs in a city or in the unincorporated area of a county.

In fiscal year 2007-08, $5.66 billion from the 1 percent Bradley-Burns sales and use taxes was allocated among all of the state's 58 counties and 478 cities. The Board contracts with each city and county to administer its local sales and use tax ordinance.

Place of Sale – Allocation of Bradley-Burns Local Tax. Revenue and Taxation Code Section 7205 of the Bradley-Burns Law specifies the "place of sale" for purposes of allocating local sales tax. Under this section, in general, all retail sales in California are consummated at the place of business of the retailer. **If a retailer has *only one* place of business** in California, the local sales tax derived from those sales made at the retailer's place of business are allocated to the city, county, or city and county in which the retailer's place of business is located. If title to the property sold passes to the purchaser in California, it is immaterial that title passes to the purchaser at a place outside the city, county, or city and county in which the retailer's place of business is located, or that the

[2] The actual Bradley-Burns county/city tax rate is 1.25%/1.00%. During the pendency of the "Triple Flip," however, the tax rates are temporarily reduced to 1.00%/0.75%. Local jurisdictions are reimbursed for the 0.25% reduction in local sales and use taxes with property tax revenues.

property sold is never within the city, county, or city and county in which the retailer's place of business is located.

If a retailer has *more than one* place of business in California, the place or places at which the retail sales occur for purposes of allocating the local sales tax is determined in accordance with regulations adopted by the Board.

Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, interprets and makes specific the laws governing the "place of sale" for purposes of allocating local tax revenues to local jurisdictions. Under paragraph (2) of subdivision (a), if a retailer has *more than one* place of business in California but only one place of business participates in the sale, the sale occurs at that place of business. If a retailer has more than one place of business in California which *participate in the sale*, the sale occurs at the place of business where the principal negotiations are carried on. If this place is where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing.

Place of Sale - Allocation of Bradley-Burns Local Tax – Jet Fuel. Section 7205(b)(2) defines the place of sale for jet fuel for the purposes of allocating local sales tax. All jet fuel sales made are allocated to the point of delivery of the jet fuel into the aircraft, regardless of whether the seller has one or more places of business in California. Thus, the place of sale of jet fuel is the city, county, or city and county where the jet fuel is delivered into the aircraft.

For multijurisdictional airports, the tax is split between the jurisdiction in which the airport is located and the jurisdiction that owns or operates the airport, as further specified in law.

In General - Countywide Pool Allocations, Buying Companies, Use Tax Direct Payment Permits.

Countywide Pool Allocations. The countywide pool is an accounting system that indirectly distributes the local portion of the sales or use tax reported for specified transactions. When title to property transfers to the California customer outside this state, the transaction is subject to use tax regardless of whether any registered place of business of the retailer participates in the sale. The local use tax is generally allocated through a countywide pool process to each city in a county where the property is put to its first functional use. Examples of taxpayers, who report use tax allocated through a countywide pool include construction contractors who are consumers of materials furnished and installed on a construction contract, out-of-state retailers who ship merchandise directly to California consumers from a warehouse or stock of goods located outside of California, and California retailers who ship merchandise directly to California consumers from a warehouse or stock of goods located outside California. These retailers receive a supplemental schedule with their sales and use tax return to report their local use tax.[3]

[3] These retailers are issued a supplemental schedule (*Schedule B – Detailed Allocation by County of 1 Percent Uniform Local Sales and Use Tax*) with their sales and use tax returns to report their local tax. *Schedule B* lists each county within the state of California. At the end of each reporting quarter, the countywide pool totals are prorated among the cities, redevelopment areas, and the unincorporated area of each county using the proportion that the directly-reported tax for each city and unincorporated area of a county bears to the total directly-reported tax for the county as a whole. The pools account for about 10% of the local sales and use tax reported, with use tax accounting for the majority of the pooled revenues.

Buying Companies. Under existing law, Section 6066 specifies that every person desiring to engage in or conduct business as a seller within California is required to apply for a seller's permit. Regulation 1699, *Permits*, subdivision (h), provides guidelines for issuing a permit to a buying company. The regulation defines a buying company as a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services, for the other entity. The regulation goes on to specify that a buying company formed for the sole purpose of redirecting local tax from the location(s) of the vendor(s) to the location of the buying company shall not be recognized as a separate entity for issuing a seller's permit.

In addition, Regulation 1699 (h)(2) provides that a buying company is not formed for the sole purpose of redirecting local sales tax if it has one or more of the following elements:

- Adds a markup to its cost of goods sold in an amount sufficient to cover its operating and overhead expenses.
- Issues an invoice or otherwise accounts for the transaction to show that the buying company is formed for a purpose other than the redirection of local sales tax.

Use Tax Direct Payment Permit. Section 7051.3 allows certain taxpayers to pay use tax directly to the Board that would otherwise be collected and remitted to the Board by the retailer making the sale. It provides for the direct allocation of use tax to the local jurisdiction of first use by the purchaser, rather than allocation through the countywide pool. This section applies to *use* tax transactions only.

A Use Tax Direct Payment Permit may be issued to any applicant who agrees to self-assess and pay use tax directly to the Board, and certifies to the Board either of the following:

- The applicant is the purchaser for its own use or is the lessee of tangible personal property (excludes vehicle leases) at a cost of $500,000 or more in the aggregate during the calendar year immediately preceding the application for the permit, or
- The applicant is a county, city, city and county, or redevelopment agency.

As of December 2008, the Board has issued 167 Use Tax Direct Payment Permits, which are in active status. Of the 167 permits, 56 are held by businesses and 111 are held by local government agencies (of the 111 permits, 98 permits are held by cities).

AMENDMENT

This bill adds Section 53084.5 to the Government Code to prohibit a local agency from entering into any form of agreement that would result, directly or indirectly, in the payment, transfer, diversion or rebate of any amount of Bradley-Burns local tax proceeds to any person for any purpose when both of the following apply:

- The agreement results in a reduction in the amount of Bradley-Burns tax proceeds that is received by another local agency from a retailer that is located within the territorial jurisdiction of that other local agency; and,
- The retailer continues to maintain a physical presence within the territorial jurisdiction of that other local agency.

This bill states that the provisions do not apply if the retailer has expanded its operations into another jurisdiction with the result that the retailer is conducting a comparable operation within the jurisdiction of both local agencies.

Definitions. This bill provides the following definitions:

"Local agency" means a chartered or general law city, a chartered or general law county, or a city and county.

"Retailer" means a retailer as defined by Section 6015 of the Revenue and Taxation Code (RTC).

"Physical presence" means the lease or ownership of any real property for the purpose of carrying on business operations.

Specified exceptions. This bill provides that its provisions do not apply to certain agreements related to the following:

- An agreement resulting in a reduction in the use tax proceeds that are distributed to the originating local agency through one or more countywide pools.
- An agreement to pay or rebate Bradley-Burns local sales and use tax revenue related to a buying company, which is defined as a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services for the other entity, as defined by the Board, and meets requirements of a buying company under RTC Sections 6066 to 6075, inclusive, and the regulations adopted pursuant to those sections.
- An agreement to pay or rebate any use tax revenue related to a use tax direct payment permit issued under RTC 7051.3.

As stated in the measure, the provisions do not apply to local tax proceeds provided by a local agency to a retailer if those proceeds are used to reimburse the retailer for the construction of public works improvements that serve all or a portion of the territorial jurisdiction of that local agency.

This bill provides that the provisions should not be interpreted to limit the ability of a local agency to contract with or otherwise enter into an agreement pursuant to subdivision (b) of RTC Section 7056.

It contains legislative findings and declarations that the economic development agreements entered into between cities and developers has resulted in an unjust reallocation of Bradley-Burns local sales and use taxes away from several cities.

As an urgency measure, the bill became effective June 5, 2009.

BACKGROUND

This bill is very similar to last year's AB 697 (Hancock). The only substantive difference is that AB 697 did not contain an urgency clause and specified an operative date of October 1, 2008. AB 697 was vetoed by Governor Schwarzenegger who wrote:

> "The historic delay in passing the 2008-2009 State Budget has forced me to prioritize the bills sent to my desk at the end of the year's legislative session. Given the delay, I am only signing bills that are the highest priority for

California. This bill does not meet that standard and I cannot sign it at this time."

The sponsor of that bill was the City of Livermore. Based on information from the City of Livermore and various newspaper articles, the City of Fillmore entered into an agreement with two private consulting firms whereby the consulting firms agreed to bring new retail businesses to the City of Fillmore in exchange for a rebate of local sales and use tax revenues. Under this agreement, the consulting firms receive 85 percent of the Bradley-Burns tax revenues that are attributable to a retailer that works with the consulting firm to relocate its sales offices into Fillmore. The consulting firms, in turn, rebate the majority of the 85 percent local tax revenue to the relocated retailer.

During the second quarter of 2008, the Board's Allocation Group received several inquiries from cities and their consultants regarding a suspected misallocation of local tax. Staff from both the Board's Allocation Group and Local Revenue Allocation Section conducted an investigation and concluded that a misallocation of local tax had occurred. All affected local jurisdictions were notified of Board staff's decision. Certain jurisdictions have filed petitions with the Board. The Board's Allocation Group is currently reviewing those petitions and will be issuing a supplemental decision. Once the supplemental decision has been issued, if the petitioning jurisdictions do not agree with that decision, their petitions will then be forwarded to the Board's Appeals Division for the scheduling of an appeals conference.

COMMENTS

1. **Purpose.** To prohibit cities and counties from using Bradley-Burns sales tax rebates as an incentive to draw sales tax-generating activities away from other communities.
2. **Amendments.** The **February 23, 2009 amendments** added coauthors and clarified that the provisions apply to agreements enacted after the effective date of this bill.
3. **This bill does not impact the Board's administration of the local tax.** Once the Board disburses funds to the local governments based on the Bradley-Burns laws and regulations, the locals then control how the money is spent or allocated.
4. **The bill's prohibition does not apply to certain agreements.** The bill's restrictions do not apply to agreements involving reductions in local use tax distributed through the countywide pool process and local tax agreements related to buying companies and use tax direct payment permits. In addition, the bill's provisions do not apply: 1) to local tax proceeds provided by a local agency to a retailer if those proceeds are used to reimburse the retailer for the construction of public works improvements that serve all or a portion of the territorial jurisdiction of that local agency, and 2) if a retailer that has expanded its operations into another jurisdiction with the result that the retailer is conducting a comparable operation within the jurisdiction of both local agencies.
5. **The bill specifies that provisions would not limit the ability of a city or county to enter into an agreement pursuant to Section 7056.** Current law provides that if any county, city and county, city, or district wishes to examine sales, transactions, and use tax records to ascertain the taxes collected for that jurisdiction pursuant to a contract between the Board and that jurisdiction, it must adopt a resolution authorizing one or more of its officials, employees, or other designated persons to examine those records.

6. **2007 Legislative Analyst's Office (LAO) report discusses ways to address problems related to present local sales tax allocation system.** In 2007, the LAO prepared a report, *Allocating Local Sales Taxes,* which discusses the negative consequences of the situs-based system and how it creates counterproductive competition between local governments for sales-tax generating businesses. Among other things, the report focuses on the use of sales tax rebates and other financial incentives by local governments to encourage the relocation of sales offices for the purposes of diverting sales taxes.

   www.lao.ca.gov/2007/sales_tax/sales_tax_012407.pdf .

Senate Bill 765 (Dutton) Chapter 615

Military Thrift Stores

Tax levy, effective October 11, 2009. Adds Section 6363.4 to the Revenue and Taxation Code.

BILL SUMMARY

This Board-sponsored bill provides, until January 1, 2014, an exemption from the sales and use tax for sales of tangible personal property by thrift stores operated by a specified designated entity that provides, in partnership with the Department of Defense, financial, educational, and other assistance to members of the Armed Forces of the United States, eligible family members, and survivors when in need.

Sponsor: Board of Equalization

LAW PRIOR TO AMENDMENT

Under existing law, the sales tax applies to the sale of tangible personal property in this state, unless specifically exempted. The Sales and Use Tax Law provides no general statutory exemption from the sales or use tax merely because the seller or the purchaser is engaged in charitable activities, is a nonprofit organization, or enjoys certain privileges under property tax statutes or income tax statutes. However, current law is sprinkled with several separate provisions designed to assist various kinds of nonprofit groups engaged in charitable activities. For example, currently under Section 6363.3 of the Revenue and Taxation Code, a sales and use tax exemption applies to sales and purchases of used pieces of clothing, household items, or other retail items sold by thrift stores operated by a nonprofit organization if the purpose of that thrift store is to obtain revenue for the funding of medical, hospice, or social services to chronically ill individuals and the other requirements of the exemption are met.

Current law also provides under Section 6375 an exemption for sales by charitable organizations qualifying for the property tax “welfare exemption” under Section 214 of the Revenue and Taxation Code, provided the organization is engaged in the relief of poverty and distress, and the sales are made principally as a matter of assistance to purchasers in distressed financial condition. Also, the property sold must have been made, prepared, and assembled or manufactured by the organization. Sales at thrift stores operated by Goodwill and Salvation Army, for example, are exempt from sales and use tax under the provisions of Section 6375, as the premises of these organizations’ thrift stores qualify for the “welfare exemption” under Section 214 (because of the fact these organizations rehabilitate persons on the premises of their thrift stores) and they meet the other requirements of Section 6375.

AMENDMENT

This bill adds Section 6363.4 to the Sales and Use Tax Law to provide an exemption until January 1, 2014 from the sales and use tax for sales of tangible personal property sold by a thrift store located on a military installation and operated by a designated entity that, in partnership with the United States Department of Defense, provides financial, educational, and other assistance to members of the Naval Service of the United States, eligible family members, and survivors when in need.

The bill defines "designated entity" as a military welfare society described in Section 1033 of Chapter 53 of Part II of Subtitle A of Title 10 of the United States Code.

The bill took effect immediately as a tax levy on October 11, 2009.

BACKGROUND

Last year, the Board sponsored similar measures (AB 1919, Silva, and SB 1450, Dutton). However, both measures failed passage in the Assembly Appropriations Committee.

COMMENTS

1. **Purpose.** To provide a small but important exemption in the law for items sold by a certain military welfare society that supports service members and their families in their time of need.
2. **Amendments.** The **August 31, 2009** amendments redefined the qualifying thrift stores by reference to a specific United States Code that defines the term "designated entity" to include specified military welfare societies. The **June 29, 2009** amendments added a sunset date of January 1, 2014.
3. **What nonprofit organization benefits?** Although other branches of the Armed Forces have similar relief societies as described in the bill, this bill essentially only applies to the sales from the thrift stores operated by the Navy-Marine Corps Relief Society, as that particular relief society is the only one that operates thrift stores. The issue had come to the Board's attention when the Society contacted the Board expressing its belief that the sales made at its thrift stores were not subject to sales or use tax. This society is a nonprofit, charitable organization that provides financial, educational, and other assistance to members of the Naval Services of the United States, and their eligible family members and survivors, when in need. The Society, operating in partnership with the Navy and Marine Corps, also operates 25 thrift stores, seven of which are located within California at various naval or marine bases in San Diego, Ridgecrest, Port Hueneme, Camp Pendleton, Coronado and Lemoore. The Society's thrift stores sell used clothing, uniforms, and household items to service members and their families at a nominal cost. The sales income realized from the thrift stores is returned to the Navy-Marine Corps community in the form of relief services. The Board believes that the price of the goods sold by the Society's thrift stores should not be increased by the addition of sales tax. The Board therefore unanimously voted to support legislation to provide an exemption.

4. **Who can shop at these thrift stores?** The thrift stores, located on military bases and not open to the public, are patronized primarily by military families, but Department of Defense employees, including retirees and civilian contractors, may also patronize these shops.

Senate Bill 809 (Committee on Veterans Affairs) Chapter 621

Itinerant Veteran Vendors

Tax levy, effective October 11, 2009, but operative April 1, 2010. Adds and repeals Section 6018.3 of the Revenue and Taxation Code.

BILL SUMMARY

This bill specifies that, until January 1, 2012, certain United States veterans are regarded as consumers, rather than retailers, of tangible personal property they sell under specified conditions.

Sponsor: Senate Committee on Veterans Affairs

LAW PRIOR TO AMENDMENT

Under California's Sales and Use Tax Law (Part 1, Division 2 of the Revenue and Taxation Code, commencing with Section 6001), except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. The law does not contain a general exemption from sales or use tax for sales of tangible personal property by veterans.

Under the law, every retailer or any other person engaged in the business of selling tangible personal property of a kind the retail sale of which is taxable in this state is required to obtain a seller's permit and report the tax on his or her sales on a return prescribed by the Board. However, California's Sales and Use Tax Law places a variety of retailers making taxable sales of tangible personal property under a "consumer" reporting status. Under a "consumer" reporting status, a qualifying retailer making otherwise taxable sales is not required to obtain a seller's permit or report tax on those sales. Rather, the qualifying retailer is only required to pay tax on his or her cost of the taxable components of the products he or she sells.

The "consumer" reporting status is primarily intended to minimize reporting burdens placed on smaller businesses and entities, while minimizing the associated revenue loss that can accompany a complete exemption from the tax. The law has extended this consumer reporting status to certain sales by such entities as nonprofit youth groups, PTAs, nonprofit veterans' organizations, various charitable organizations, schools and school districts, optometrists, veterinarians, podiatrists, licensed hearing aid dispensers, and others with respect to certain products they sell.

AMENDMENT

This bill adds Section 6018.3 to the Sales and Use Tax Law to specify that, until January 1, 2012, a "qualified itinerant vendor" is a consumer of, and shall not be considered a retailer of, tangible personal property owned and sold by the qualified itinerant vendor, except alcoholic beverages and tangible personal property sold for more than $100.

The bill specifies that a person is a "qualified itinerant vendor" when all of the following apply:

1) The person was a member of the United States Armed Forces, who received an honorable discharge or a release from active duty under honorable conditions from service,
2) The person is unable to obtain a livelihood by manual labor due to a service-connected disability.
3) For the purposes of selling tangible personal property, the person is a sole proprietor with no employees, and
4) The person has no permanent place of business in this state.

The bill defines “permanent place of business” as any building or other permanently affixed structure, including a residence that is used in whole or in part for the purpose of making sales of, or taking orders and arranging for shipment of, tangible personal property, and would exclude from that term, any building or other permanently affixed structure, including a residence, used for any of the following:

1) The storage of tangible personal property.
2) The cleaning or the storage of equipment or other property used in connection with the manufacture or sale of tangible personal property.

The bill specifies that its provisions do not apply to either of the following:

1) A person engaged in the business of serving meals, food, or drinks to a customer at a location owned, rented, or otherwise supplied by the customer, or
2) A person operating a vending machine.

The bill becomes operative on April 1, 2010, which is the first day of the first calendar quarter commencing more than 90 days from the bill’s effective date.

BACKGROUND

For the past 11 years or so, several veterans have argued that state law which exempts honorably discharged veterans from locally-imposed license taxes and fees also exempts itinerant veterans from any tax imposed by the state. More specifically, it has been argued that Business and Professions Code Section 16102 exempts honorably discharged veterans from application of the sales and use tax on sales of food products and carbonated beverages from a mobile food cart. This section reads in its entirety as follows:

> “Every soldier, sailor or marine of the United States who has received an honorable discharge or a release from active duty under honorable conditions from such service may hawk, peddle and vend any goods, wares or merchandise owned by him, except spirituous, malt, vinous or other intoxicating liquor, without payment of any license, tax or fee whatsoever, whether municipal, county or State, and the board of supervisors shall issue to such soldier, sailor or marine, without cost, a license therefore.”

This provision was enacted in 1893 pursuant to AB 74, and was described in the chaptered bill as “An act to establish a uniform system of county and township government.” In its present form (which has remained unchanged since 1941) Section 16102 falls within Chapter 2 of Part 1 of Division 7 of the Business and Professions Code, entitled *Licensing by Counties*.

In 1999, the Board held that this provision does not apply to sales or use taxes imposed pursuant to California's Sales and Use Tax Law. The Board's decision was subsequently challenged unsuccessfully in Los Angeles Superior Court (No. BC 210257). The Board's decision is also consistent with that of the Office of Legislative Counsel in its two opinions specific to this issue rendered in 1998 and 2006, concluding that the exemption provided in this section only applies to county license tax and license fees, and does not apply to sales and use taxes.

COMMENTS

1. **Purpose.** To restore in the Sales and Use Tax Law, the 1893 exemption for service-connected disabled veterans unable to earn a living by manual labor in relation to hawking, peddling, and vending.

2. **Amendments.** The **August 31, 2009 amendments** made a nonsubstantive change and added Assembly Member Ma as a coauthor. The **July 15, 2009 amendments** added the sunset date of January 1, 2012 and excluded sales for more than $100 from the provisions, so that the specified United States veterans will continue to be regarded as retailers, rather than consumers, of sales of tangible personal property for more than $100.

3. **What will a qualifying veteran's tax obligations be?** Under this bill, a qualifying itinerant disabled veteran making taxable sales of goods, wares or merchandise owned by him or her will not be required to report sales tax on his or her sales of these items. Instead, those veterans will only be required to pay tax on their cost of any taxable purchases of the items or the component parts of the items he or she sells. For example, if a veteran is selling his or her own paintings, the veteran will pay tax on his or her purchase of the paint, brushes, and canvas used to make the painting. The sale of the painting, itself, is thereafter exempt from tax (provided the selling price is $100 or less). Under this bill, if the qualifying veteran makes no sales of alcoholic beverages and makes no sales in excess of $100, the veteran will not be required to obtain a seller's permit, file sales tax returns, or remit sales tax on his or her sales of the goods he or she sells. This essentially eliminates the sales tax compliance costs and associated recordkeeping that can be unduly burdensome for disabled veterans.

4. **Qualifying veterans will need to provide evidence of disability to qualify.** Up until January 1, 2009, Business and Professions Code Section 16001.5 authorized cities to issue business licenses to honorably discharged or honorably relieved United States veterans without payment of any business license tax or fee for their sales of goods they own. To qualify, the law required, among other things, that the veteran be physically unable to obtain a livelihood through manual labor (however, the law did not require that the veteran have a service-connected disability). Although this qualification is no longer necessary through enactment of AB 1952 (Stats. 2008, Ch. 435), we contacted several cities to determine how they administered Section 16001.5 prior to January 1, 2009. The cities that we contacted indicated that they required the veteran to provide confirmation from a physician that he or she had such a physical impairment. We expect that we will require a similar physician confirmation of the veteran's disability. Also, since the bill requires that the disability be service-related, we will require that a qualifying veteran also provide written confirmation of that disability from the Department of Veteran Affairs.

5. **Bill will not be problematic to administer.** The bill applies to a small group of itinerant disabled veteran vendors. When this bill becomes law, the Board will no longer require these individuals to hold a seller's permit.

6. **Related legislation.** AB 1265 (Ma), as amended June 1, 2009, also contained similar provisions. However, on September 2, 2009, it was gutted and amended with provisions outside the Board's purview.

Senate Bill 15 (Krekorian) Chapter 17, Third Extraordinary Session

Qualified Motion Picture Tax Credit

Tax levy, effective February 20, 2009, but operative January 1, 2011. Among its provisions, adds Sections 6902.5 to the Revenue and Taxation Code.

BILL SUMMARY

Among other things, this bill authorizes an income tax credit equal to the applicable percentage, as specified, of the qualified expenditures attributable to the production of the qualified motion picture in California.

In lieu of claiming that credit, the bill allows qualified taxpayers to claim either a refund of qualified sales and use tax taxes paid under the Sales and Use Tax Law, or a credit against qualified sales and use taxes imposed on the qualified taxpayer, that is equal to the income tax credit amount, or any portion thereof, that would be otherwise allowed pursuant to the income tax laws.

Sponsor: Budget Committees

LAW PRIOR TO AMENDMENT

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property in this state. The use tax is imposed on the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless that property is specifically exempted.

With regard to the motion picture industry, the Sales and Use Tax Law provides the following:

- Section 6378 of the Sales and Use Tax Law provides an exemption from the 5.25 percent state sales and use tax, for the sale and purchase of any tangible personal property purchased for use *primarily* in teleproduction or other post production services, as described, by a qualified person that is *primarily* engaged in teleproduction or post production activities, as defined in Code 512191 of the North American Industry Classification System Manual, published by the United States Office of Management and Budget, 1997 edition.
- Section 6010.4 provides that when certain persons form partnerships to reduce the cost of producing motion pictures through the sharing of the use of equipment and other assets, the furnishing of that property, without the transfer of title, by the partnership to its members for the purpose of producing motion pictures by its members does not constitute a "sale" or a "purchase" and, therefore, no tax applies to the furnishing of that property.

- Section 6010.6 provides that "sale" and "purchase" do not include the following: (1) any transfer of any qualified motion picture, or any interest or rights therein, when the transfer is prior to the date that the qualified motion picture is exhibited or broadcast to its general audience, and (2) the performance of qualified production services, as defined, in connection with the production of any qualified motion picture, as defined. Therefore, no tax applies to these transactions.
- Sections 6006 and 6010 provide that leases of motion pictures or animated motion pictures, including television, films, and tapes, (except video cassettes, tapes, and discs leased for private use under which the lessee does not obtain the right to license or broadcast) do not constitute "sales" or "purchases." Therefore, no tax applies to these transactions.

AMENDMENT

This bill, among other things, adds Section 6902.5 to the Sales and Use Tax Law, Section 17053.85 to the Personal Income Tax Law, and Section 23685 to the Corporation Tax Law, to do, among other things, the following:

1. Allow a credit to a qualified taxpayer against the personal income tax or the corporation franchise tax an amount equal to:
    - 20 percent of the qualified expenditures attributable to the production of a qualified motion picture in California, or
    - 25 percent of the qualified expenditures attributable to the production of a television series that relocated to California, or an independent film, which is defined as a film with a budget between $1 million and $10 million produced by a non-publicly traded company which is not more than 25 percent owned by a publicly traded company.
2. Define "qualified taxpayer" to mean a taxpayer who has paid or incurred qualified expenditures and has been issued a credit certificate by the California Film Commission (CFC).
3. Define "qualified expenditure" to mean an amount paid or incurred to purchase or lease tangible personal property used within this state in the production of a qualified motion picture and payments, including qualified wages, for services performed within this state in the production of a qualified motion picture.
4. Define "qualified wages" to mean all of the following:
    - Any wages required to be reported under Section 13050 of the Unemployment Insurance Code that were paid or incurred by any taxpayer involved in the production of a qualified motion picture.
    - The portion of any fringe benefits paid or incurred by any taxpayer involved in the production of a qualified motion picture.
    - Any payments made to a qualified entity for services performed in this state by qualified individuals, which is an individual who performs services during the production period in an activity related to the production of a qualified motion picture.

5. Define "qualified motion picture," to mean, among other things a feature with a minimum budget of $1 million and a maximum budget of $75 million. It excludes from the definition productions such as commercials, music videos, news programs, talk shows, game shows, awards shows, private noncommercial productions (e.g., weddings or graduations).
6. Require the CFC to determine and designate who is a qualified taxpayer and to establish criteria for allocating the credits.
7. Specify that the CFC will allocate not more than $100 million in tax credits each year during the period of 2009-10 through 2013-14 on a first-come-first served basis.
8. Require the CFC to establish a procedure for verifying qualified expenditures and to establish audit requirements that must be satisfied before a credit certificate may be issued by the CFC to a qualified taxpayer.
9. Allow qualified taxpayers, or affiliates that have been assigned any portion of the tax credit amount by the qualified taxpayers, in lieu of claiming the franchise or income tax credit, to either claim a refund of qualified sales and use tax paid, or a credit against qualified sales or use taxes imposed on the qualified taxpayer or imposed on the affiliate that is equal to the credit amount or any portion thereof, that would otherwise be allowed under Section 17053.85 or 23685.
10. "Qualified sales and use taxes" is defined to mean any state sales and use taxes imposed by Part 1 (commencing with Section 6001) of the Sales and Use Tax Law. Provides that "qualified sales and use taxes," does <u>not</u> include taxes imposed by Section 6051.2 and 6201.2 (Local Revenue Fund), 6051.5 and 6201.5 (Fiscal Recovery Fund), Part 1.5 (Bradley-Burns Uniform Local Sales and Use Tax Law), Part 1.6 (Transactions and Use Tax Law), or Section 35 of Article XIII of the California Constitution (Local Public Safety Fund).
11. Require the Business, Transportation and Housing Agency to report to the Legislature by December 31, 2015, on the economic impact of the credit. The bill authorizes this agency to consult with industry representatives, labor organizations and government agencies, including the Board and the Franchise Tax Board, before completing the report.

As a tax levy, the bill became effective February 20, 2009, but operative January 1, 2011.

BACKGROUND

Two similar measures were introduced in the 2007-08 Legislative Session. SB 740 (Calderon and Portantino) would have authorized an income tax credit equal to the applicable percentage, as specified, of the direct tax revenues attributable to the production of a qualified motion picture. SB 359 (Runner) would have authorized income tax credits based on certain wages paid or amounts paid to purchase or lease certain property used to produce motion pictures or commercials in California. Both bills were never heard in committee.

Two other similar measures were introduced in the 2005-06 Legislative Session. AB 777 (Nunez) would have provided a 12 percent income tax credit , and SB 58 (Murray and Pavley) would have provided a 15 percent income tax credit of the qualified amount for qualified wages or qualified property, as defined, paid or incurred during the production period of a qualified motion picture production. AB 777 was never heard in committee, and SB 58 died in the Senate Revenue and Taxation Committee.

COMMENTS

1. **Purpose.** This bill enacts the economic stimulus revenue provisions of the 2009-10 Special Session Budget Agreement. According to a February 20, 2009 press release from the Governor's Office, the economic stimulus package is designed to create jobs and boost California's economy. It includes incentives and gives a competitive edge to companies that are creating jobs for Californians, and encourages companies to expand in, and relocate to, California. These incentives in this measure are designed to lure television and movie production back to California.

2. **This analysis focuses primarily on the provisions contained in proposed Section 6902.5 which would fall under the Board's purview.** Some concerns are noted below:

   - **Definition of "qualified sales and use taxes."** The bill defines qualified sales and use taxes to mean state General Fund sales and use taxes *only*. The bill specifies that "qualified sales and use taxes" *does not* include those taxes imposed under:

     - Sections 6051.2 and 6201.2 impose a 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment.
     - Sections 6051.5 and 6201.5 impose a 0.25 percent state tax allocated to the Fiscal Recovery Fund which is dedicated to the repayment of Economic Recovery Bonds.
     - Section 35 of Article XIII of the California Constitution imposes a 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments for program realignment.
     - Part 1.5 (commencing with Section 7200) imposes a 1 percent local tax which is allocated to cities and counties pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law.
     - Part 1.6 (commencing with Section 7251) imposes varying rates ranging from 0.10 to 1 percent which are allocated to local agencies pursuant to the Transactions and Use Tax Law.

     Thus, a qualified taxpayer is allowed to claim a refund or credit against state General Fund sales and use taxes only. It is unclear whether a credit or refund would include payments made for interest or penalty charges related to the qualified sales and use taxes.

     In addition, paragraph (5)(A) of subdivision (a) provides that *qualified sales and use taxes* means any state sales and use taxes imposed by Part 1 on the *operative date of the act adding this section*. AB 3 of the Third Extraordinary Session (Chapter 18, signed by the Governor on February 20, 2009) increases, temporarily, the rate of the General Fund portion of the state sales and use tax by 1 percent. The increase is effective starting April 1, 2009. It is unclear whether *qualified sales and use taxes* includes the additional 1 percent state sales and use tax rate increase.

- **The bill should clarify what is meant by qualified sales or use taxes *imposed*.** The bill allows a qualified taxpayer to claim a refund or credit for qualified sales or use taxes imposed on the qualified taxpayer (or an affiliate) and requires the qualified taxpayer or affiliate to submit to the Board the amount of qualified sales and use taxes the claimant remitted to the Board. Since use tax is imposed on purchasers (as for example on certain leases of property, and property purchased from out-of-state retailers), it is unclear whether the refund or credit is applicable to use tax paid by a qualified taxpayer or an affiliate to other retailers, or just the amount actually remitted to the Board. In addition, it is unclear whether a refund or credit is allowable for sales tax reimbursement paid by qualified taxpayers to California retailers. This should be clarified in the bill, in order to determine the impact this measure will have on the Board's workload.

- **It is not clear whether a qualified taxpayer who does not pay income tax or pays only the corporate minimum franchise tax may receive a refund of sales tax reimbursement or use tax.** Existing section 6902.2 provides a similar refund of sales tax reimbursement or use tax that taxpayers may claim "in lieu of" claiming the manufacturers' investment credit on franchise or income tax returns. For taxpayers who actually paid only the corporate minimum franchise tax because they satisfied their franchise tax liability by claiming other credits, such as research and development credits, a controversy arose as to whether such a taxpayer may claim a refund of sales tax reimbursement or use tax "in lieu of" claiming the franchise tax credit. The bill should clarify whether the Legislature intends for qualified taxpayers who actually pay no income tax or the corporate minimum franchise tax to be able to receive refunds of sales tax reimbursement or use tax.

- **It is not clear whether the credits attributable to an independent film, and subsequently sold to an unrelated party, are allowed to offset any qualified sales and use taxes.** Subdivision (c) of Sections 17053.85 and 23685 allow a qualified taxpayer to sell the credit to an unrelated party if the credit is attributable to an independent film, as defined. However, these same provisions contained in Sections 17053.85 and 23685 are not contained in Section 6902.5 of the Sales and Use Tax Law. It is not clear whether a credit issued for an independent film, and sold to an unrelated party, may be used against sales and use taxes.

- **Period for obtaining a refund or applying a credit needs clarification.** The bill provides that a qualified taxpayer may claim a refund for qualified sales and use taxes paid during the period described in subdivision (c)(1)(D). Subdivision (c)(1)(D) requires the qualified taxpayer to submit to the Board the amount of qualified sales and use taxes that the taxpayer had remitted to the Board during the period commencing on the first day of the calendar quarter immediately before the beginning of the production period, *and ending on the date the taxpayer was required to file its most recent sales and use tax return with the Board*. It is unclear what period would be the most recent period for which the taxpayer would be required to have filed a return.

- **Should the Board provide the FTB with information on the amount of the refund or credit issued to the qualified taxpayer or affiliate?** Subdivision (g) requires the Board to provide to the FTB an annual listing of the qualified taxpayers or affiliates who, during the year, make an irrevocable election to claim a refund or credit in lieu of income taxes. The Board is to provide FTB with the *credit amount claimed* by each qualified taxpayer or the a *portion of the credit amount claimed* by each affiliate. Would it be useful for the FTB to receive information regarding the actual amount refunded for any qualified sales and use taxes paid by the qualified taxpayer or affiliate, and the actual amounts credited against any qualified sales and use taxes imposed on the qualified taxpayer or affiliate?

3. **Related legislation.** This bill is identical to ABx3 15 (Chapter 10, Krekorian), which was also signed by the Governor Schwarzenegger on February 20, 2009.

Senate Bill 16 (Ducheny) Chapter 23, Fourth Extraordinary Session

Accounts Receivable Discharge Threshold and Collection Fee

Urgency measure, effective July 28, 2009. Amends Section 13943.2 of, and adds Sections 16583.1 and 16583.2 to, the Government Code.

BILL SUMMARY

Among its provisions, this 2009-10 Budget revision trailer bill (1) increases the amount of debt which state agencies can discharge from collections activity from $250 to $500, and (2) authorizes state agencies to impose a reasonable fee for the actual cost of its collections of past due accounts.

Sponsor: Budget Committee

LAW PRIOR TO AMENDMENT

Existing Government Code (GC) Section 13943.2 provides the State Victim's Compensation and Government Claims Board (SVCGC) with authority to approve state agency requests to discharge accounts receivable up to $250, if the state agency's efforts have not resulted in payment and it would not be cost beneficial to pursue additional collection efforts.

Under Section 13943.2, the Board has established a "small balance" write-off process in which the Board writes off balances of $250 or less, as specified, after a period of 180 days upon the liability becoming due and payable, with specified exceptions (e.g., security is available).

Existing Chapter 4.3 (commencing with Section 16580) of Part 2 of Division 4 of Title 2 of the GC, known as the Accounts Receivable Management Act, requires state agencies to allocate collection resources based on giving highest priority to those accounts receivables with the highest expected return. The Accounts Receivable Management Act also authorizes each state agency to sell part or all of its accounts receivable to private debt collectors under specified conditions. This Act, however, does not authorize state agencies to charge a fee for their costs related to collecting delinquent accounts receivable. Further, there is no other statutory authority allowing the Board to charge a fee for its costs of collecting these delinquencies.

The State's collection procedures to collect delinquent accounts are detailed in the State Administrative Manual Section 8776 (et seq).

Existing law authorizes the Board to use various collection actions to collect delinquent accounts receivables, including but not limited to: bank levies, liens, wage garnishments, till-tap or keeper warrants, permit revocations, alcoholic beverage license suspensions, seizures of assets, offsets, and court actions. Of these collection actions, there are only four actions for which the Board charges the taxpayer a fee for its actual costs of collection:

Reinstatement Fee. The Board may revoke a permit if a taxpayer does not file a tax return on time or pay a tax or fee liability on time. The Board is also authorized to revoke a permit if a taxpayer is required to post security but does not. Current law authorizes the

Board to charge a $50 reinstatement fee when a permit has been revoked and the taxpayer requests that its permit be reinstated. A $50 reinstatement fee applies to each business location.

Till-tap or Keeper Warrant. If a taxpayer has not paid its tax or fee liability that is due and payable, the Board is authorized to serve a civil warrant to the California Highway Patrol or the local sheriff to enter the taxpayer's place of business and collect the gross receipts or contents of the cash register(s). Current law authorizes the Board to collect warrant fees that are assessed by the California Highway Patrol or local law enforcement agency to place an officer in the place of business.

Sale of Alcoholic Beverage License. The Board may seize and sell a liquor license upon termination of a business and for which a taxpayer is delinquent in the payment of taxes or penalties. The Board may charge taxpayers for any costs it incurs because of the seizure and sale, including but not limited to, advertising, long distance calls, postage, and notices of publication.

Sale of Other Property. The Board may seize and sell other types of real and personal property, such as a boat, home, or vehicle to satisfy a delinquent tax liability. The Board may charge taxpayers for any costs it incurs associated with the seizure and sale of such property. For example, the Board may issue a warrant to a county sheriff to seize and sell a tax debtor's vehicle. Any costs related to the seizure and sale are paid from the sale proceeds, with the remaining proceeds applied to the outstanding liability.

AMENDMENT

This bill amends GC Section 13943.2 to increase the amount of debt that state agencies can discharge from collection activity from $250 to $500. In addition, this bill adds GC Sections 16583.1 and 16583.2 to do the following:

- Authorize a participant under the Accounts Receivable Management Act to impose a reasonable fee, not to exceed the actual costs, for its cost of collection on a past due account. GC Section 16581 defines "participant" to mean <u>all</u> state agencies, departments, and offices.
- Require a state agency to submit an annual report to the State Controller of its accounts receivables and discharged accounts. The Controller is required to inform a state agency, not less than 60 days before the annual report is due, of both the format and submission date for the annual report.

As an urgency measure, this bill became effective July 28, 2009.

BACKGROUND

Assembly Bill 2591 (Chapter 506, Stats. 2006) required seven specified state agencies to submit an annual report to the Department of Finance (DOF) on the status of that agency's delinquent accounts receivables, and its efforts to collect these accounts during the previous fiscal year. The DOF must submit an annual report to the Legislature on the status of delinquent accounts receivable of state agencies. The reporting agencies are: The Board, Franchise Tax Board (FTB), State Lands Commission, Department of General Services, Department of Motor Vehicles, Department of Real Estate, and the Department of Corrections.

Since the enactment of AB 2591, there have been two reports submitted to the Legislature. As a result of the findings from the first report, 2006-07 Delinquent Accounts Report, the DOF established an Accounts Receivable (AR) Workgroup for purposes of improving administrative procedures and collections on delinquent accounts. The AR Workgroup, over the past year, evaluated existing AR processes and procedures, implemented new administrative procedures for locating debtors and for performing reviews of ARs, evaluated and submitted initial recommendations on the feasibility of selling the state's discharged debts or ARs, identified that statewide AR amounts may be misleading, and made updates to the State Administrative Manual.

On April 3, 2009, the DOF submitted the second report, 2007-08 Delinquent Accounts Report, to the Assembly Budget Committee, Senate Budget and Fiscal Review Committee, and Assembly and Senate Appropriations Committees. The report discusses actions taken, and recommendations made by the AR Workgroup. Two of these recommendations proposed to increase the threshold to discharge delinquent accounts and allow state agencies to charge a fee for their costs of collecting delinquent accounts receivables.

According to the DOF, over the course of next year, the AR Workgroup will continue to meet periodically to identify additional improvements to the overall management of AR practices and processes, which will include evaluating ways that the state can increase potential revenues.

COMMENTS

1. **Purpose.** To enact statutory changes necessary to implement improvements to state agencies collection of accounts receivable that have been adopted as part of the 2009-10 Conference Budget package.

2. **Implementation considerations.** Discharging accounts receivable under $500. Board staff does not see a problem administering the new threshold amount. It will continue to discharge balances of $500 or less in accordance with the procedures outlined in the State Administration Manual Section 8776.6, and the Board's existing criteria for write-offs of small balances.

   Imposing reasonable fees to cover collection costs. Numerous issues need to be addressed by Board staff in order to successfully administer the proposed collection fee. In part, these issues are as follows:

   - Would the same amount of fee be imposed on all types of ownership (sole owner, limited partnership, general partnership, corporation, limited liability company)? In general, collection of corporation accounts can involve an additional workload to verify corporate entity status, mail additional notices, search for corporate assets, and more. This added workload might warrant imposing a higher collection fee on corporation accounts, versus individual accounts.

   - When would the fee be assessed? At what point in the collection process would a fee be assessed? For Board liabilities, once a liability becomes due and payable, collection action may be initiated. There are two types of liabilities—self-assessed and Board-assessed. Self-assessed liabilities are when a taxpayer files a return, but 1) does not make a payment, 2) makes a partial payment, 3) makes a payment with a check that is dishonored by the bank, and 4) files a late payment or return without penalty and interest charges included in the payment. When a self-assessed liability occurs, a receivable is established, and collection action begins.

- Board-assessed liabilities are liabilities for which a notice of determination (billing) has been issued by Board staff. They become due and payable 30 days from the date on which a determination is issued (unless a taxpayer has filed a timely petition for redetermination). Collection action may begin immediately after a determination is due and payable. At what point in the collection process would a delinquent receivable be subject to the proposed fee? As an alternative, a fee may be imposed on delinquent accounts that remain unpaid for 120, or 180 or more days after the liability was first due to the Board. These are just a few of the alternatives to be considered by Board staff.

- If a taxpayer enters into an installment payment agreement and fully complies with all terms of the agreement, would the taxpayer be subject to a collection fee? For example, an audit of a taxpayer's business discloses an underreporting of taxable sales. During an exit discussion, the taxpayer requests to pay the audit liability by making monthly payments. If the taxpayer is eligible for an installment payment agreement and complies with the terms of the agreement, would the Board assess a collection fee?

- Does the Board have sufficient authority under GC Section 16583.1 to impose collections fees? Section 16583.1 provides general statutory authority for state agencies to impose collection fees, however, it does not contain administrative provisions with regard to imposing the proposed fees and the amount of the fees.

- If a taxpayer disagrees with the assessment of the fee, will the taxpayer be able to contest the assessment by filing an appeal?

- GC Section 16583.1 allows, but does not require, a state agency to impose a reasonable fee, not to exceed the actual costs, to recover that agency's collection costs on a past due account. What do actual costs include? Would actual costs include those costs for the Board's collection program as specified in the annual Budget Act?

- Under current law, when a tax or fee becomes due and payable but remains unpaid, a perfected and enforceable state tax lien is created for the amount due plus interest, penalties, and other costs. The lien attaches to real and personal property of a tax debtor by operation of law, and continues in effect for ten years from the date of its creation, unless it is sooner released or otherwise discharged. This is referred to as a "statutory lien." Would the proposed collection fees be covered under these statutory lien provisions?

3. **Proposed collection fees will require approval by the Board Members.** Board staff's recommendations to impose a collection fee must be placed on a Board Agenda for discussion and approval by the Board Members.

4. **The Legislative Analysts Office (LAO) recommends that the Board assess fees for dishonored checks, installment payment agreements, and offers in compromise agreements.** In its 2009-10 Budget Analysis, the LAO recommended that the Legislature require the Board and FTB to make certain changes for purposes of generating additional General Fund revenues and deterring taxpayers from making payments from accounts with insufficient funds. Those changes are as follows:

   <u>Penalties for bad checks and money orders.</u> According to the LAO, "Bad checks and money orders disrupt the tax collection process and delay the deposit of funds into the

state's General Fund. FTB assesses a $15 penalty on bad checks and money orders of less than $750, and if the dishonored check or money order exceeds $750, the penalty increases to 2 percent of the face value. The Board does not charge a penalty on bad checks or money orders. The federal government assesses greater penalties for bad checks and money orders than the state." According to the LAO, aligning the amount of California penalties with federal penalties would serve as a greater deterrent to taxpayers paying taxes with checks and money orders that have insufficient funds. In addition, increasing the penalties for bad checks and money orders would result in General Fund revenues of approximately $400,000 for 2009-10 and nearly $1 million beginning 2010-11, and thereafter.

Fees for installment payment agreements. The Board does not charge a fee for installment payment agreements. In contrast, the FTB and Internal Revenue Service (IRS) do charge fees for this service. FTB charges a flat fee of $20 per agreement, which according to FTB, does not cover the cost to provide the service or reflect the higher cost of processing non-electronic fund transfer (EFT) payments. The IRS charges $52 per agreement for EFT payment agreements and $105 per agreement for paper check agreements. According to the LAO, if the Board implements a fee and the FTB increases their existing fee this would result in combined annual General Fund savings of approximately $4 million annually.

Fees for offers in compromise agreements (OIC). According to the LAO, "since OICs are a service provided to taxpayers, it would be appropriate to assess a fee. The IRS charges a flat fee of $150 per OIC. If FTB and BOE charged an application fee of $75 for each OIC, it would result in General Fund savings of approximately $400,000 annually."

TABLE OF SECTIONS AFFECTED

SECTIONS		BILL AND CHAPTER NUMBER		SUBJECT
§6018.3	Add Repeal	SB 809	Ch. 621	Itinerant veteran vendors
§6018.9	Add Repeal	AB 1486	Ch. 538	Nonprofit organizations' promotional items
§6051.7	Add	AB x3 3	Ch.18	Temporary sales and use tax rate increase
§6069	Amend	AB 1547	Ch. 545	Reinstatement fee increase
§6201.7	Add	ABx3 3	Ch.18	Temporary sales and use tax rate increase
§6225	Add	ABx4 18	Ch. 16	Use tax registration
§6248	Amend	AB 1547	Ch. 545	Vehicles, vessels, and aircraft
§6363.4	Add	SB 765	Ch. 615	Military thrift stores
§6902.5	Add	SBx3 15	Ch. 17	Qualified motion picture tax credit
§7099.1	Add	AB 129	Ch. 411	Confidentiality: taxpayer communications
§7204.3	Amend	ABx4 12	Ch. 12	Cost allocation model
§7273	Amend	ABx4 12	Ch. 12	Cost allocation model
§ 13943.2	Amend	SBx4 16	Ch. 23	Accounts receivable discharge
§ 16583.1	Add	SBx4 16	Ch. 23	Collection fee
§ 16583.2	Add	SBx4 16	Ch. 23	Accounts receivable discharge report
§ 53084.5	Add	SB 27	Ch. 4	Local tax agreements