

Amend Sections 6452.1, 6487.3, and 18510 of the Revenue and Taxation Code to *require* persons who have failed to report their use tax obligations to the Board to report their use tax liability on their tax returns filed with the Franchise Tax Board.

**Source: Legislative and Research Division
Sales and Use Tax Department**

Existing Law

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 of Equalization (Board) on or before the last day of the month following the quarterly period in which the purchase was made. 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.

In an effort to increase the public's awareness of the use tax and to encourage voluntary compliance in reporting the use tax, legislation enacted in 2003 (SB 1009, Ch. 718), required the Franchise Tax Board (FTB) to revise the personal income tax and corporations tax returns to add a separate line for use tax reporting. This legislation allowed consumers to *elect to* report use tax on their income tax returns for purchases made on or after January 1, 2003, and through December 31, 2009, as an alternative to reporting the tax to the Board (retailers and certain consumers already registered with the Board, however, may not use this alternative).

This Proposal

This proposal would *require* consumers 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. This proposal would also eliminate the January 1, 2009 sunset date of the provisions which provide for the separate line on the FTB returns for use tax reporting.

In an FTB analysis of individual returns from tax year 2003, it found that taxpayers who self-prepared their returns were nearly eight times more likely to declare use tax than those who used a tax practitioner. Nearly 63 percent of all individual returns FTB received were practitioner-prepared. Yet, only 16.6 percent of all use tax declarations were made on practitioner-prepared returns. While the dollar amount of use tax reported on the FTB returns is increasing (in

2004, use tax of \$2.8 million was reported, in 2005, \$4.6 million, and in 2006, \$5.5 million was reported), voluntary compliance is still very low. The Board has estimated that the total dollar amount of unreported use tax by consumers is over \$400 million.

One of the reasons that practitioner-prepared returns do not reflect use tax is that some tax practitioners believe that they can disregard their ethical obligation to inquire about a client's use tax obligation when preparing a client's income tax returns, since the income tax return form and instructions simply provide for an election to report the tax. This proposal is seeking to dispel this misconception by eliminating the election to report on the FTB return. Instead, the proposal would specify that the tax is *required* to be reported on that return if the purchaser failed to already report the tax to the Board. These provisions would not, however, preclude the Board from making any determinations for qualified use tax against any persons in accordance with the current provisions of the Sales and Use Tax Law.

It is anticipated that these proposed changes would enable both tax practitioners and consumers to have a better understanding of their obligation to properly report use tax liabilities. In return, the competitive disadvantage in-state retailers have compared to out-of-state retailers that are not required to collect the California use tax may be improved.

Section 6452.1 of the Revenue and Taxation Code is amended to read:

6452.1. (a) Notwithstanding Section 6451, every person that purchases tangible personal property, the storage, use, or other consumption of which is subject to qualified use tax, as defined in subdivision ~~(b)~~(d), that is otherwise required to report and remit that tax pursuant to this part and fails to do so, ~~may elect to~~ shall report and remit qualified use tax on an acceptable tax return.

~~(b) (1) A person that reports qualified use tax on an acceptable tax return is deemed to have made the election authorized by this section. (2) (A)~~ In the case of a married individual filing a separate California personal income tax return, an election may be made to report either one-half of the qualified use tax or the entire qualified use tax on his or her separate California personal income tax return.

~~(B) (2)~~ If an individual elects to report one-half of the qualified use tax, that election will not be binding with respect to the remaining one-half of the qualified use tax owed by that individual and that individual's spouse.

~~(c) An election to report qualified use tax on an acceptable tax return shall be irrevocable.~~ An acceptable tax return that contains use tax shall be considered a tax return for purposes of this part.

(d) For purposes of this section:

(1) "Acceptable tax return" means a timely filed original return that is filed pursuant to Article 1 (commencing with Section 18501), Article 2 (commencing with Section 18601), Section 18633, Section 18633.5 of

Chapter 2 (commencing with Section 18501) of Part 10.2, or Article 3 (commencing with Section 23771) of Chapter 4 of Part 11.

(2) (A) Except as provided in subparagraph (B), “qualified use tax” means the use tax imposed under this part, Section 35 of Article XIII of the California Constitution, the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)) that has not been paid to a retailer holding a seller’s permit or certificate of registration-use tax.

(B) “Qualified use tax” does not include:

(i) Use tax that applies to a mobilehome or a commercial coach that is required to be registered annually pursuant to the Health and Safety Code or use tax that applies to a vehicle subject to identification under Division 16.5 (commencing with Section 38000) of the Vehicle Code, or to a vehicle that qualifies under the permanent trailer identification plate program pursuant to subdivision (a) of Section 5014.1 of the Vehicle Code.

(ii) Use tax imposed on a vehicle, vessel, or aircraft.

(iii) Use tax imposed on a lessee of tangible personal property.

(iv) Use tax imposed on purchases of cigarette and/or tobacco products for which the purchaser is registered with the board as a cigarette and/or tobacco products consumer.

~~(e) If a A person elects that is required to report qualified use tax on an acceptable tax return, ~~that person shall report and remit the qualified use tax due on purchases of tangible personal property made during the preceding comply with all of the following:~~~~

~~— (1) The qualified use tax shall be reported on and remitted with an acceptable tax return.~~

~~— (2) The qualified use tax shall be reported on and remitted with an acceptable tax return that is required to be filed for the taxable year in which the liability for the qualified use tax was incurred.~~

(f) (1) The penalties and interest imposed under this part, the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)) shall apply to use tax reported as qualified use tax on an acceptable return.

(2) Any claims for refunds or credits of any use tax reported as qualified use tax on an acceptable tax return shall be made in accordance with Chapter 7 (commencing with Section 6901) of this part.

(3) Qualified use tax shall be considered to be timely reported and remitted for purposes of this part, the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), and the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), if the qualified use tax is timely reported on and remitted with an acceptable tax return in accordance with the provisions of this section.

(g) Notwithstanding a person’s ~~election to remit and to report~~ payment of qualified use tax on an acceptable tax return, the State Board of Equalization

is not precluded from making any determinations for understatements of qualified use tax against that person in accordance with Part 5 (commencing with Section 6451).

(h) Any payments and credits shown on the return, together with any other credits associated with that person's account, of a person that ~~elects~~ is required to report qualified use tax on an acceptable tax return shall be applied in the following order:

(1) Taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), including penalties and interest, if any, imposed under Part 10.2 (commencing with Section 18041).

(2) Qualified use tax reported on the acceptable tax return in accordance with this section.

(i) (1) This section does not apply to a person who is otherwise required to hold a seller's permit or to register with the State Board of Equalization pursuant to Part 1 (commencing with Section 6001) of this division.

(2) This section applies to purchases of tangible personal property made on or after January 1, ~~2003~~2007, in taxable years beginning on or after January 1, ~~2003~~2007, ~~and on or before December 31, 2009, and as of that date becomes inoperative, unless a later enacted statute extends the operation of this section.~~

~~(3) Notwithstanding this section becoming inoperative as described in paragraph (2), any provisions in this section or Section 18510 relating to collection activities attributable to qualified use taxes reported prior to the inoperative date of this section shall continue in the same manner as if this section were still operative.~~

Section 6487.3 of the Revenue and Taxation Code is amended to read:

6487.3. (a) (1) For persons that ~~elect~~ are required to report qualified use tax in accordance with Section 6452.1, except in the case of fraud, intent to avoid this part or authorized rules and regulations issued by the board, or the gross understatement of qualified use taxes, every notice of a deficiency determination with respect to the qualified use tax shall be mailed within three years after the last day for which an acceptable tax return is due or filed, whichever occurs later.

(2) In the case of a gross understatement of qualified use tax, every notice of a deficiency determination with respect to the qualified use tax shall be mailed within six years after the last day for which an acceptable tax return is due or filed, whichever occurs later.

(3) For purposes of this subdivision a "gross understatement of qualified used tax" is a deficiency that is in excess of 25 percent of the amount of qualified use tax reported on a person's acceptable tax return. In the case of married individuals filing separate California personal income tax returns, the total amount of qualified use tax reported will be considered in determining whether there is a gross understatement of qualified use tax.

(4) For purposes of this section “acceptable tax return” means a timely filed original return that is filed pursuant to Article 1 (commencing with Section 18501), Article 2 (commencing with Section 18601), Section 18633, Section 18633.5 of Chapter 2 (commencing with Section 18501) of Part 10.2, or Article 3 (commencing with Section 23771) of Chapter 4 of Part 11.

(b) This section applies to reporting of purchases of tangible personal property made on or after January 1, ~~2003~~2007, in taxable years beginning on or after January 1, ~~2003~~2007, ~~and on or before December 31, 2009, and as of that latter date becomes inoperative, unless a later enacted statute extends the operation of this section.~~

Section 18510 of the Revenue and Taxation Code is amended to read:

18510. (a) (1) The Franchise Tax Board shall revise the returns required to be filed pursuant to this article, Article 2 (commencing with Section 18601), Section 18633, Section 18633.5, and Article 3 (commencing with Section 23771) of Chapter 4 of Part 11 in a form and manner approved by the State Board of Equalization, to ~~allow~~ enable a person to report and pay qualified use tax in accordance with the provisions of Section 6452.1.

(2) Within 10 working days of receiving from the Franchise Tax Board the returns described in paragraph (1), the State Board of Equalization shall do either of the following:

(A) Approve the form and manner of the returns and notify the Franchise Tax Board of this approval.

(B) Submit comments to the Franchise Tax Board regarding changes to the returns that shall be incorporated before the State Board of Equalization approves the form and manner of the returns.

(b) Any payments and credits shown on the return, together with any other credits associated with that person’s account, of a person that ~~elects to report~~ reports qualified use tax on an acceptable tax return shall be applied in the following order:

(1) Taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), including penalties and interest, if any, imposed under this part.

(2) Qualified use tax as reported on the acceptable tax return, in accordance with Section 6452.1.

(c) The Franchise Tax Board shall transfer the qualified use tax received pursuant to Section 6452.1, and any information the State Board of Equalization deems necessary for its administration of the use tax, to the State Board of Equalization within 60 days from the date the use tax is received or the acceptable tax return is processed, whichever is later.

(d) This section shall be operative for returns filed for taxable years on and after January 1, ~~2003~~2007, ~~and ending on or before December 31, 2009, and as of that date becomes inoperative, unless a later enacted statute extends the operation of this section.~~