

Amend Section 6591.5 of the Revenue and Taxation Code to provide that the interest rate for overpayments is the same as the interest rate for underpayments.

Source: Legislative Division

Under existing law, persons who are late in payment of their tax obligations are required to pay a penalty of 10 percent of the tax, plus interest on those unpaid taxes from the date the tax was due to the date upon which they are paid. Persons who have overpaid their tax to the state are granted credit interest on the overpayment (when it is determined that the overpayment was not intentional or a result of carelessness) from the first day of the calendar month following the month during which the overpayment was made to the last day of the month following the date upon which the refund is approved by the Board.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the Board to taxpayers on overpayments of tax and the rate of interest paid by taxpayers to the Board on underpayments of tax. However, AB 2181 and SB 179 (Chs. 85 and 88, respectively) significantly changed the computation of credit interest on overpayments of tax. Those measures provide that interest on underpayments is calculated based on specified provisions of the Internal Revenue Code, plus three percentage points. This rate is currently set at 11 percent, but will increase to 12 percent effective January 1, 2001. Interest on overpayments of tax is based on the bond equivalent rate of 13-week treasury bills auctioned. That rate is currently set at 5 percent, but will increase to 6 percent effective January 1, 2001.

The July 1, 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to resolve the budget deficit. This legislation was prompted by a 1990 landmark court decision (*Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300) involving new sales and use tax issues for U. S. Government contractors in California. As a result of that decision, U.S. Government contractors would be entitled to refunds of overpayments of taxes previously paid to the Board on specified transactions with the U. S. Government. Because of the potentially significant amount of tax and the period of time the overpayments occurred, it was recognized that these refunds would include a very significant amount of credit interest. With the reduced rate of interest, naturally, the state would not lose such a significant amount of revenue.

Legislation introduced in the past to equalize the interest rates include: AB 2972 (Mays, 1992 Legislative Session), AB 2083 (Takasugi, 1993 Legislative Session), and AB 3487 (Andal, 1994 Legislative Session), AB 1189 (Takasugi, 1995 Legislative Session), AB 1940 (Woods, 1995 Legislative Session), AB 397 (Hannigan, 1995 Legislative Session), and AB 222 (Takasugi, 1997 Legislative Session). AB 2083 and AB 3487 both failed passage in the Assembly Revenue and Taxation Committee. AB 2972 passed the Legislature, but was vetoed by the Governor. AB 1189 was held in the Senate Appropriations Committee; AB 1940 was also held in Senate Appropriations

Committee, but its interest provisions later became part of a comprehensive tax reform package (AB 397) that was vetoed by the Governor. AB 222 was amended early in 1998 to instead provide for a one percent increase in the credit interest rate, and, with that amendment, was held in the Senate Appropriations Committee.

Assembly Bill 2612 (Ch. 607, Statutes 2000), as introduced by Assembly Member Brewer, contained language that would have equalized the interest rates. However, the language that would have equalized the interest rates was amended to provide that it is the *intent* of the Legislature to require that the rate of interest accruing on both overpayments and underpayments of sales and use tax be determined in the same manner.

This proposal would provide that interest on both overpayments as well as underpayments would be the same rate (effective 01/01/01 that rate will be 12 percent). Since all of the Special Tax and Fee Laws currently reference Section 6591.5, the interest on both underpayments and overpayments of tax or fees under the Special Tax and Fees programs administered by the Board would also be calculated in accordance with the provisions of this proposal.

The purpose of this proposal is to eliminate the inequitable disparity that currently exists in the rate of interest charged on late payments and the rate of interest paid on refunds. Since the refunds due under the Aerospace case have all been paid, it seems logical and certainly equitable to now go back to previous law and equalize the interest rates between refunds and liabilities. This would address the concerns of many taxpayers who view this disparity as extremely unfair.

In addition, other major taxing agencies don't have such a disparity. According to the Franchise Tax Board, its interest rate on both underpayments and overpayments is the same - currently, 8 percent compounded daily. The Internal Revenue Service has no disparity in rates for underpayments and overpayments - currently, 9 percent compounded daily. The annual revenue loss associated with this proposal is estimated as follows:

Increased Credit Interest Payments

Year	Special Taxes	State Sales & Use Tax	Total	Local	Transit	Total
2000-01	\$ 237,273	\$ 795,455	\$1,032,728	\$ 357,955	\$ 106,591	\$ 1,497,274
2001-02	1,694,805	5,681,818	7,376,623	2,556,818	761,364	10,694,805
2002-03	2,813,377	9,431,818	12,245,195	4,244,318	1,263,864	17,753,377
2003-04	2,900,000	9,722,222	12,622,222	4,375,000	1,302,778	18,300,000

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

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

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

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

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

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

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

~~(1)~~

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

~~(2)~~

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

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

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

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

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

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