DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**08/17/09**	Bill No:	**AB 469**
Tax:	**Sales and Use**	Author:	**Eng, et al.**
Related Bills:		Position:	**Support as Sponsor**

BILL SUMMARY

This Board of Equalization (Board)-sponsored bill 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, as specified. This bill would also eliminate the January 1, 2009 sunset date on the provisions which provide for the separate line on the Franchise Tax Board (FTB) income tax returns for use tax reporting.

SUMMARY OF AMENDMENTS

The amendments to this bill since our last analysis substitute "adjusted gross income" for "taxable income" for purposes of the base upon which the estimated qualified use tax is estimated for the use tax table.

ANALYSIS

CURRENT 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 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. Generally, when a person is late in payment of his or her use tax obligations, the Board imposes a 10 percent penalty, plus interest, currently at the rate of 8 percent per year.

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 FTB to revise the personal income tax and corporations tax returns to add a separate line for use tax reporting. While the use tax law was enacted in 1935, this was the first time a line to report use tax appeared on the state's income tax returns. 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 (certain consumers and retailers already registered with the Board, however, may not use this alternative).

Proposed Law

This bill would amend Sections 6452.1, 6453, 6487.3, and 18510 of the Revenue and Taxation Code to require persons, except as specified, who have failed to report their use tax obligations to the Board on taxable purchases during the taxable year in which the FTB return is required to be filed, to report their "qualified use tax" liability on that return.

Among its provisions, the bill would provide that "qualified use tax" means either of the following:

1) The state, local and district use tax that has not been paid to a retailer, as specified, or
2) For one or more single nonbusiness purchases of individual items of tangible personal property with a sales price of less than $1,000, the estimated amount of use tax due based on the person's adjusted gross income as reflected in the use tax table shown in the accompanying instructions of the state income tax return.

The bill would additionally exclude from its provisions, any person registered with the Board as a cigarette and/or tobacco products consumer.

The bill would also require FTB to revise the accompanying instructions for filing FTB returns in a form and manner approved by the Board.

This bill would also eliminate the January 1, 2009 sunset date for the provisions that provide for the separate line on the FTB income tax returns for use tax reporting.

The bill would become effective on January 1, 2010, and would apply to taxable purchases made during the calendar year 2010 for which use tax was not paid to the Board.

BACKGROUND

Last year, the Board sponsored AB 1957 (Eng) which is substantially the same as this bill. That measure passed the Assembly, but failed passage in the Senate Revenue and Taxation Committee.

In 2007, the Board also sponsored AB 969 (Eng) to 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. Unlike AB 1957 and this measure, however, AB 969 did not have provisions for an optional use tax table, and it would have become effective on January 1, 2008 for taxable purchases made during the calendar year 2007. Although passed by the Legislature, the Governor vetoed AB 969. In his veto message, the Governor cited the following:

> "Although increasing use tax reporting is desirable, I have concerns that the effective date of January 1, 2008 is too soon for taxpayers to compile adequate records of their purchases that are subject to the use tax for calendar year 2007. Further, I would like to see a plan to better educate taxpayers on the use tax, as I suspect that many taxpayers have little knowledge of the tax and may unknowingly fail to pay it."

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board in an effort to close the tax gap by increasing taxpayers' as well as tax practitioners' compliance with the use tax laws.

   In an FTB analysis of individual returns from tax year 2008, FTB found that taxpayers who self-prepared their returns were three times more likely to declare use tax than those who used a tax practitioner. Nearly 64 percent of all individual returns FTB received were practitioner-prepared. Yet only 23 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, in 2006 and 2007, $5.5 million each year was reported, and in 2008, $9 million was reported), voluntary compliance is still very low. The Board has estimated that the total annual dollar amount of unreported use tax is over $1.1 billion (unreported use tax by consumers is estimated to be over $400 million, and for businesses not registered with the Board, over $600 million).

   Instead of having an option to either report to the Board or to the FTB, this measure would *require* consumers and businesses that aren't already registered with the Board to report their use tax obligations to the FTB if they failed to report the tax to the Board during the preceding taxable year.

   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 bill is seeking to dispel this misconception by eliminating the election to report on the FTB return. Instead, the bill 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.

   It is anticipated that these proposed changes would enable tax practitioners, consumers, and business entities not registered with the Board 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.

2. **The August 17, 2009 amendments** substitute "adjusted gross income" for "taxable income" for purposes of the base upon which the estimated qualified use tax is estimated for the use tax table. **The April 2, 2009 amendments** were clarifying changes with respect to individual nonbusiness purchases, by referring to those purchases as "one or more single nonbusiness purchases of individual items of tangible personal property."

3. **With the April 1, 2009 increase in the sales and use tax rate, this legislation is even more critical.** One concern with a higher sales and use tax rate is that more purchasers will seek ways to avoid the tax by purchasing products from out-of-state retailers that are not required to collect the California use tax – further widening the tax gap. Many purchasers simply believe that tax is not due when buying goods over the Internet. Enactment of this bill would assist in assuring that purchasers and tax practitioners are made aware of the use tax reporting obligations by retaining the use tax line on the state income tax return and

providing simplified instructions that explain what purchases are subject to the use tax and how to report the tax.

4. **The optional use tax table would provide simplicity.** A use tax table would make compliance with reporting use tax more convenient for taxpayers who know they have made untaxed purchases but have not kept receipts from those purchases. For individual purchases of less than $1,000, the table would reflect the amount of use tax due based on the person's California adjusted gross income as shown in the instructions in the state income tax booklet. For individual purchases of $1,000 or more, taxpayers would be required to report the actual amount of use tax due.

   Of the 38 states that impose both an income tax and a use tax on purchases of tangible personal property, 21 states provide for individuals to report their use tax obligations on their income tax return. Nine of those states incorporate a use tax table, and according to a November 2007 report prepared by the Research Department of the Minnesota House of Representatives, *Use Tax Collection on Income Tax Returns in Other States,* many of those states that allow purchasers to report their use tax obligations using the tables have higher participation rates. Although those states collect less use tax per return than do states without lookup tables, the greater participation rate in those states overwhelms the effect of lower average use tax reporting per return.

5. **What would the use tax table look like?** The bill does not incorporate a specific use tax table that taxpayers could use to determine their use tax liability if they opted to do so. The Board would therefore determine the applicable use tax amount that is commensurate with varying levels of adjusted gross income, and the table would likely be similar to other states' tables. To illustrate five other states' tables, a taxpayer that has an annual adjusted gross income (AGI) or taxable income (TI) of $50,000 with no individual taxable purchases of $1,000 or more, the use tax liability would be:

State	**Rate of Tax**	**Use Tax**
New York (AGI)	7% to 8.75%	$21
North Carolina (TI)	6.75% to 7.25%	33.75
Oklahoma (AGI)	4.5% to 9%	28
Massachusetts (AGI)	5%	25
Michigan (AGI)	6%	31

6. **Enactment of this bill would exclude persons registered with the Board as cigarette and tobacco products consumers.** Under current law, persons that have a reporting obligation to the Board are not allowed to report their use tax obligations on their FTB returns. Instead, they are required to remit their taxes directly to the Board (see Section 6452.1 (i)(1)). This bill would additionally specify that the use tax attributable to certain cigarette and tobacco products consumers' purchases is not "qualified use tax" for purposes of reporting the tax on the FTB return. This relates to a program the Board administers to collect taxes due on purchases of cigarettes and/or tobacco products from out-of-state sellers.

Under this program, the Board registers consumers that acquire these products from out-of-state retailers without payment of the state excise taxes or use tax (the Board uses purchaser information provided by sellers who comply with the federal Jenkins Act, which requires sellers to provide purchasers' names and addresses). Under this program, consumers are required to file returns with the Board and pay all applicable excise and use taxes due. (There are two types of excise taxes administered by the Board that are imposed on cigarettes and tobacco products distributed in California: 1) the cigarette tax, and 2) the cigarette and tobacco products surtax). Therefore, those consumers registered by the Board under this program would be excluded from the provisions of the bill.

7. **No new penalties would be imposed.** This measure would not impose any new penalties for a person's failure to pay the use tax on the FTB return or to the Board. Current law already provides for a 10 percent penalty, as well as interest (and has done so since 1935), for a person's late payment of the tax.

COST ESTIMATE

The Board's costs associated with this measure would be commensurate with the number of additional returns that would be filed with FTB (currently the Board incurs personnel costs for collecting the unpaid use tax reported on the FTB returns, refunding use tax reported in error, answering questions from taxpayers about the use tax, and allocating the local and district taxes included in the tax reported on the FTB returns). However, we anticipate that the additional revenue would substantially exceed the additional costs.

Since the line was incorporated into the FTB returns, the Board has reimbursed FTB for associated costs, as shown below.

2003-04	$1,007,316
2004-05	237,038
2005-06	239,458
2006-07	198,649*
2007-08	118,859*

* This decrease is attributable to the FTB's cost of printing the tax information booklets that accompany the tax returns it mails. The Board shares in that cost because the booklets contain information about use tax. The decrease in printing cost is due to the success of FTB's e-file program (printed tax booklets are not mailed for these filers).

REVENUE ESTIMATE

The Minnesota House of Representatives report (mentioned in Comment 4 on page 4) indicates that, on average, the average participation rate in states that have look-up tables for estimating use tax liability is 1.63 percent, and the average amount of use tax collected from those who participate is $57. (Currently, the participation rate in California without a look up table is 0.2%). About 14.8 million individual income tax returns are filed in California annually. Assuming that 241,240 individual income tax returns (14.8 million x 1.63%) would include an average of $57 in use tax, approximately $13.75 million in use tax revenues would be collected as follows:

State General Fund (6%)	$9,207,589
State Fiscal Recovery Fund (1/4%)	383,650
Local Revenue Fund (1/2%)	767,299
Local Public Safety Fund (1/2%)	767,299
Local and County (1%)	1,534,598
Special districts (.71%)	1,089,565
Total	$13,750,000

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.