



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

**DRAFT**

Date Amended:	<b>01/06/10</b>	Bill No:	<b><u>AB 1178</u></b>
Tax:	<b>Sales and Use</b>	Author:	<b>Block</b>
Related Bills:			

***This analysis only addresses the provisions that impact the Board.***

**BILL SUMMARY**

This bill would provide a partial *state* sales and use tax exemption on college textbooks and supplies, as defined, by students enrolled in institutions of higher education for the period beginning July 1, 2011, and until January 1, 2015.

**ANALYSIS**

**CURRENT LAW**

Under existing law, the sale of books and school supplies are subject to the sales or use tax to the same extent as the sale of any other tangible personal property not specifically exempted or excluded from tax by statute. With the exception of school yearbooks and catalogues, tax applies to the sale of any books and school supply items to elementary, high school as well as college students. Tax also applies to the sale of any books and school supply items to a library, to the state, and to any political subdivision of the state.

Under current law, the 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:

<b>Rate</b>	<b>Jurisdiction</b>	<b>Purpose/Authority</b>
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))
<sup>1</sup> 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 (Section 7203.1 of the RTC, operative 7/1/04); Dedicated to county transportation purposes
8.25%	Total Statewide Base Rate	

<sup>1</sup> Effective April 1, 2009, AB X3 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.

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In addition to the statewide base rate of 8.25 percent, cities and counties are authorized pursuant to the Transactions and Use Tax Law (Parts 1.6 and 1.7, commencing with Section 7251 of the RTC) to impose additional voter-approved taxes (also known as special taxing districts). Effective April 1, 2010, there are 114 special taxing districts imposing these additional taxes at rates ranging from 0.10 percent to 1 percent.

#### PROPOSED LAW

This bill would add Section 6361.7 to the Revenue and Taxation Code to provide a partial *state* sales and use tax exemption (3 percent for the period beginning July 1, 2011 through and including June 30, 2012, and 5 percent for the period beginning July 1, 2012 through and including December 31, 2014) for the sale and purchase of textbooks and supplies, as defined, that are purchased by a student enrolled in an institution of higher education, as defined, and the textbooks and supplies are recommended or required for a course in which the student is enrolled.

The bill would make the following definitions:

- “Textbooks” means any published material that is principally designed for use by a student at an institution of higher education as a source of instructional material and includes, but is not limited to, any book or edition of a book, that is directed or recommended by an instructor at an institution of higher education to a student to purchase for use as a basis for a course of study in which that student is enrolled at that institution.
- “Supplies” means pens, paper, blue books, notebooks, art supplies, uniforms, safety equipment, tools, computer paper, and flashdrives necessary for the course of study in which a student is enrolled at the institution of higher education. Supplies would not include computers, printers, or related hardware and software.
- “Institution of higher education” means the University of California, the California State University, or a California Community College.

The bill would specify that for the period on and after July 1, 2011, and before July 1, 2012, the exemption shall not apply to any taxes levied pursuant to Section 6501.2 and 6201.2 (Local Revenue Fund), 6051.5 and 6201.5 (Fiscal Recovery Fund), and Section 35 of Article XIII of the California Constitution (Local Public Safety Fund), and with respect to any taxes levied at a rate of 2 percent pursuant to Section 6051 and 6201 (General Fund).

The bill would specify that for the period on or after July 1, 2012, and before January 1, 2015, the exemption shall not apply to any taxes levied pursuant to Sections 6501.2 and 6201.2 (Fiscal Recovery Fund), 6051.5 and 6201.5 (Local Revenue Fund), and pursuant to Section 35 of Article XIII of the California Constitution (Local Public Safety Fund).

In addition, the bill would specify that the exemption shall not apply to any tax levied by a county, city, or district pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law or the Transactions and Use Tax Law.

As a tax levy, the bill would become effective immediately upon enactment, but operative on July 1, 2011. The provisions of this bill would remain in effect until January 1, 2015, and as of that date be repealed.

## BACKGROUND

Several bills that would have provided an exemption for school-related purchases were introduced during the 2001-2002 Legislative Session, but failed to pass. These bills included the following:

- AB 1077 (Mountjoy, 2001) would have provided a *state* sales and use tax exemption for the purchase of any tangible personal property by a K-12 public school or school district for use by that school or district.
- AB 1246 (Leonard, 2001) would have provided a sales and use tax exemption for any textbook that is purchased by a student at an institution of higher education or from an entity whose primary purpose is to provide textbooks to students attending institutions of higher education, for use as a learning resource in any course of study at that institution.
- AB 2636 (Leonard, 2002) would have provided a *state* sales and use tax exemption for the purchase of any instructional materials, as defined, by any qualifying school entity, as defined.
- SB 546 (McClintock, 2001) would have provided a sales and use tax exemption for the sale and purchase of any textbook, as defined, purchased by a K-12 public school or school district, or an accredited private school, or sold to a student of an accredited private school or institution of higher education.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to help make college textbooks and supplies more affordable for college students.
2. **Definition of textbooks is specific.** The partial exemption would apply to new or used textbooks as well as other books, including related workbooks, which are required or recommended by an instructor for a course at an institution of higher education. The partial exemption would apply to books produced commercially or produced by the institution or the instructor. The partial exemption *would not* apply to books that are not required or recommended for a course at an institution of higher education. Also, it appears that the exemption would apply to books on computer disks, CD-ROMs or audiocassettes, so long as they are required or recommended books by the instructor.
3. **Definition of supplies needs clarification.** The partial exemption would apply to supplies, as specified, which are recommended or required by the instructor for a course at an institution of higher education. The bill defines “supplies” as pens, paper, blue books, notebooks, art supplies, uniforms, safety equipment, tools, computer paper, and flashdrives necessary for the course of study in which a student is enrolled at an institution of higher education. Board staff notes that the terms uniforms, safety equipment, and tools are somewhat broad. Would uniforms include scrubs used by nursing students? Would safety equipment include a sporting helmet, glove or mitt used by students enrolled in physical education courses? Would tools include a stethoscope or a hammer purchased by a medical or veterinarian student? In order to effectively administer the proposed exemption, the institution or course instructor would need to provide retailers with a list of required or recommended supply items.

4. **Exemption is not limited to college bookstores.** College textbooks and supplies may be purchased partially tax exempt from any retailer, including college bookstores, retail bookstores (e.g., Barnes and Noble), and other retailers (e.g., Best Buy, Costco, Target, Rite-Aid, and Walmart), and may be purchased by mail order, telephone, or the Internet.
5. **The proposed exemption would apply only to the state general fund portion of the sale and use tax rate.** For the period July 1, 2011 through and including June 30, 2012, the exemption would apply only to a portion of the state general fund tax rate or 3 percent. For the period July 1, 2012 through and including December 31, 2014, the exemption would apply to the full state general fund portion of the tax rate or 5 percent. This partial exemption would not apply to the Bradley-Burns local taxes and transactions and use taxes. The partial exemption would also not apply to the two statewide 0.50 percent local taxes known as the Local Revenue Fund tax and Local Public Safety Fund tax, as well as the 0.25 percent state Fiscal Recovery Fund tax.

To illustrate how the exemption would apply, if an engineering student attending California State University Sacramento purchased a total amount of \$500 in textbooks for his or her classes, as well as a total amount of \$100 in computer paper, pens, paper, blue books and notebooks, the proposed exemption would result in the following:

Period	Total Total Tax Rate Total Amount	Exemption Tax Rate Exempt Amount	Tax Applies Tax Rate Taxable Amount
<u>7/1/11 through 6/30/12</u>			
Tax rate	7.75%	3%	4.75%
Amount-Total/Exempt/Taxable	\$46.50	\$18.00	\$28.50
<u>7/1/12 through 12/31/14</u>			
Tax rate	7.75%	5.00%	2.75%
Amount-Total/Exempt/Taxable	\$46.50	\$30.00	\$16.50

6. **The proposed exemption would not apply to students enrolled in a private college or university.** The proposed partial exemption would apply only to students enrolled in the University of California, the California State University, or a California community College.
7. **Affected retailers would be required to keep specific documentation to support the proposed exemption.** The law provides that for the purpose of the proper administration of the sales and use tax and to prevent evasion of the sales tax, it shall be presumed that all gross receipts are subject to the tax until the contrary is established. In order for affected retailers to rebut this presumption, they would be required to establish to the satisfaction of the Board that the books and supplies they sell for which a partial exemption is claimed under the provisions of this bill are not subject to the 5 percent tax (or 3 percent for the fiscal year 2011-2012). As an example, a college student may purchase *The Help*, a current best seller about black domestic servants in early 1960's Mississippi, for pleasure reading, or for purposes of satisfying a sociology course. Consequently, the retailer would be required to obtain and retain documentation that 1) the book is actually

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sold to a student of an institution of higher education (e.g., a valid student identification card and a letter from the institution that the student is enrolled in a course(s) at that institution), and 2) the book is being purchased by the student upon direction of an instructor as a basis for a course of study at that institution (e.g., a letter from the course instructor). Although this would place an added record keeping burden on these retailers (as well colleges and college instructors), without such documentation, virtually every book or supply item sold could escape taxation, resulting in a higher revenue loss than anticipated.

In addition, even if students provide proof of enrollment, as well as documentation showing that the student is purchasing a required or recommended textbook or supply item for a course in which the student is enrolled, there is no way to prevent a student from making multiple purchases of items from other retailers. A student can purchase supplies from Walmart, and then purchase additional supplies from Target.

8. **Partial exemptions complicate administration of the tax.** This bill would only partially exempt the sale of textbooks and supplies. This would add an additional burden on affected retailers, who, in order to reimburse themselves for the remaining tax due, would be required to calculate the remaining applicable tax on each sale of a qualifying book or supply item to a college student. The retailer must then segregate these partially exempt sales from other sales in order to properly complete its sales and use tax return.

In addition, the sales and use tax returns would require modification, since no other sales of tangible personal property are partially exempt from the 5 percent portion of the sales and use tax rate (partial exemption would be 3 percent for the fiscal year 2011-12). There are currently five partial tax exemptions in effect: 1) farm equipment and machinery, 2) diesel fuel used for farming and food processing, 3) timber harvesting equipment and machinery, 4) teleproduction equipment, and 5) racehorse breeding stock. The rate of each of these partial exemptions is 5.25 percent. Also, the Board's experience with its administration of these partial exemptions indicates that preparing the tax return becomes more complicated and results in an increase in errors.

## **COST ESTIMATE**

Because of the partial exemption, administrative costs would be incurred in computer programming, return revisions and return processing. In addition, some costs would be incurred in notifying affected retailers, preparing a special publication and exemption certificate, and answering inquires from the public and taxpayers. An estimate of these costs is pending.

## **REVENUE ESTIMATE**

### **BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

This bill would add Section 6361.7 to the Revenue and Taxation Code to provide a sales and use tax exemption for the sale and purchase of any textbook and supplies that are purchased by a student enrolled at an institution of higher education, and the textbooks and supplies are recommended or required for a course in which the student is enrolled. Consequently, the sales and use tax rate that students pay for textbooks and supplies would be less than that for other tangible goods. However, the reduced tax rate itself would change during the second year that the measure is in effect. Specifically, under current law, the General Fund sales and use tax rate will be five

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percent, effective July 1, 2011. Under this proposal, students would pay a General Fund sales and use tax rate of two percent in 2011-12, and this rate would be eliminated in 2012-13, 2013-14, and the first half of 2014-15.

The bill includes the following definitions:

- “Textbooks” means any published material that is principally designed for use by a student at an institution of higher education as a source of instructional material and includes, but is not limited to, any book or edition of a book, that is directed or recommended by an instructor at an institution of higher education to a student to purchase for use as a basis for a course of study in which that student is enrolled at that institution.
- “Supplies” means pens, paper, blue books, notebooks, art supplies, uniforms, safety equipment, tools, computer paper, and flashdrives necessary for the course of study in which a student is enrolled at the institution of higher education. Supplies would not include computers, printers, or related hardware and software.
- “Institution of higher education” means the University of California, the California State University, or a California Community College.

Based on the estimated number of California college students impacted (1.9 million) in 2011-12 and their estimated average per capita spending on textbooks (\$990) and supplies (\$257), total purchases of textbooks and supplies in 2011-12 is estimated to be \$2.3 billion. The estimated state sales and use tax loss from the three percent exemption in 2011-12 is \$70 million (\$2.3 billion x 3.0%). The total state sales and use tax (5%) loss is estimated to be \$122 million in FY 2012-13, and \$128 million in FY 2013-14. The revenue loss for the first half FY 2014-15 is estimated to be \$48 million, reflecting the seasonal pattern of textbook and supply purchases.

**REVENUE SUMMARY**

The General Fund revenue impact for exempting college textbooks and supplies purchases under this proposal would be as follows:

	Estimated Revenue Loss (in millions)
FY 2011-12	\$70
FY 2012-13	\$122
FY 2013-14	\$128
Jul 1, 2014- Dec 31, 2015	\$48

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