# STATE BOARD OF EQUALIZATION
# STAFF LEGISLATIVE BILL ANALYSIS

| | | | |
|---|---|---|---|
| Date Amended: | **04/21/03** | Bill No: | **AB 1741** |
| Tax: | **Sales and Use** | Author: | **Assembly Revenue and Taxation Committee** |
| Board Position: | **Section 1: Support – Board sponsored** | Related Bills: | |

**BILL SUMMARY**

This bill would, among other things, do the following:

- Until January 1, 2006, limit the period in which the Board of Equalization (Board) may assess unpaid use taxes for qualified California purchasers that voluntarily self-report their use tax obligations to 3 years.
- Require the Board to prepare a report to the Legislature on the benefits of this provision, as specified.

**Summary of Amendments**

The amendments to this bill since the previous analysis add a sunset date of January 1, 2006 and add the provision that would require the Board to prepare a report. The amendments also add other unrelated changes to the law that would be administered by the Office of the State Controller.

**ANALYSIS**

**Current Law**

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed 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.

Under the law, in cases where a purchaser fails to file a return and report their use tax obligations, the Board may assess past due tax obligations for a period as far back as eight years.

## Proposed Law

This bill would add Section 6487.06 to the Sales and Use Tax Law to limit, until January 1, 2006, the statute of limitations for the collection of unreported use tax for qualified purchasers to three years. The bill would also provide relief of any penalties imposed upon qualified purchasers if the Board determines that the failure to timely report or remit the tax was due to reasonable cause.

The bill would define "qualifying purchaser" to mean a person that voluntarily filed an Individual Use Tax Return for tangible personal property that is purchased from a retailer outside this state for use in this state and that meets all of the following conditions:

- Registered with the Board.
- Filed an Individual Use Tax Return with the Board.
- The purchaser is not engaged in business in this state as a retailer, as defined in Section 6015.
- The purchaser has not been contacted by the Board regarding failure to report the use tax.
- The Board has made a determination that the purchaser's failure to file an Individual Use Tax Return or to otherwise report, or pay the use tax was due to reasonable cause.

The bill would require the Board to submit a report to the Legislature before January 1, 2005 that includes the following:

- The number of qualifying purchasers who received the benefits afforded by this bill and the amount of use tax revenue received.
- Recommendations for modifying, eliminating, or continuing the operation of, any or all of the provisions of these provisions.

The bill would become operative on January 1, 2004.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board in an effort to encourage voluntary compliance with the use tax laws by reducing the existing period within which the Board may issue a notice of determination against taxpayers from eight years to three. The purpose of this measure is to encourage individuals as well as businesses who currently do not hold seller's permits (e.g., food processors or service industry businesses) to report their use tax with the incentive of a three-year statute of limitations. The statute of limitations for issuing determinations for vehicle, vessel and aircraft purchases will remain at the current eight years.
2. **The April 24, 2003 amendments would, among other things, add a sunset date and require the Board to prepare a specified report.** These amendments would not be problematic. The remaining amendments incorporated into the bill would be administered by the Office of the State Controller.

3. **Bill is patterned after similar statute for out-of-state retailers.** The shortened statute of limitations proposed in this measure is patterned after Section 6487.05 which was added to the Sales and Use Tax Law in 1994, effective January 1, 1995. Section 6487.05 also shortens the statute of limitations for unregistered out-of-state retailers who have nexus in California that voluntarily register with the Board. As long as the out-of-state retailer had not been previously registered with the Board or contacted by the Board regarding his or her use tax obligations, the statute of limitations for past tax obligations is also three years.

4. **Bill is expected to increase use tax revenues.** The largest area of noncompliance under the Sales and Use Tax Law is the use tax. This bill is expected to increase use tax collections, since those purchasers that have been discouraged to remit use tax because of the 8-year statute of limitations, would now be encouraged to remit.

## COST ESTIMATE

Enactment of this measure would result in minimal absorbable costs.

## REVENUE ESTIMATE

### Background, Methodology, and Assumptions

This measure would limit the period of time for which a deficiency determination may be issued for such reported use tax to three years. Under current law, the time period for which a deficiency determination may be issued for such reported use tax is up to eight years.

The intent of this new legislation is to mirror existing Section 6487.05 in the Revenue and Taxation Code. This section allows *out-of-state retailers*, under certain conditions, to voluntarily come forward to register and pay their tax liability with a statute of limitations of three years. In addition, this section (as does the proposed section) allows for relief of penalty under certain conditions.

Under the Board's Voluntary Disclosure Program and with respect to Individual Use Tax Returns filed from 7/1/00 to 7/29/02, an average of approximately 280 use tax returns are currently filed voluntarily each year, with an average tax liability of $7,180 per return in reported tax. Total tax reported averages about $2.0 million per year (280 x 7,180 = $2.0 million). We do not have data on the number of years of liabilities represented by these payments. However, staff believes that most of them are likely to be for one year's liability. These tax reportings exclude penalty and interest payments.

Board staff believes that it would not be unreasonable to assume that the annual number of taxpayers coming forward to report tax would approximately double if this measure becomes law. Assuming the same average tax reported per taxpayer would imply increased revenues of approximately $6 million over a three-year statute of limitations time period (2.0 x 3 = 6.0 million). Many of these reported tax liabilities are likely to be one-time payments. However, Board staff believes that new taxpayers would continue to come forward at approximately the same numbers in future years, implying that these revenues would be ongoing rather than one-time in nature.

As the span of years of statute of limitations increases beyond the proposed three years, the number of voluntary tax-reporting individuals would be expected to decrease, thus decreasing revenues. We had no information to use as a basis of interpolating expected tax reportings for various time periods between three and eight years. However, discussions with Board staff suggest that voluntary reportings would fall much more rapidly after three years, than after four, five, or more years. Mathematically, this taxpayer behavior pattern implies a nonlinear interpolation between three and eight years. We assumed annual percentages from an approximate geometric progression to interpolate expected additional payments between three and eight years.[1] Then we added these revenues to the $2 million per year taxpayers are currently voluntarily reporting.

**Revenue Summary**

Based on the information available and the assumptions made, we estimate that this bill would increase annual use tax revenues by approximately $6 million with a three-year statute of limitations time period. Total use tax voluntarily reported would be $8 million per year. The table below shows total annual expected tax reported for statute of limitations time periods ranging from three to seven years.

| Number of Years of Statute of Limitations | Total Annual Voluntarily Reported Use Tax (Million of Dollars) |
|---|---|
| 8 (Current Law) | $2.0 |
| 7 | $2.4 |
| 6 | $2.8 |
| 5 | $3.5 |
| 4 | $5.4 |
| 3 (Proposed Law) | $8.0 |

**Qualifying Remarks**

Since this measure presents a new reporting incentive, we have no actual information on how many additional taxpayers would decide to voluntarily report. Nor do we know their tax liabilities or proportions of payments that would be ongoing or one-time in nature. Staff used its best professional judgment to make decisions on these assumptions. However, different assumptions will result in different revenue figures.

| | | | |
|---|---|---|---|
| Analysis prepared by: | Sheila T. Sarem | 916-445-6579 | 05/07/03 |
| Revenue estimate by: | Dave Hayes | 916-445-0840 | |
| Contact: | Margaret S. Shedd | 916-322-2376 | |

[1] Specifically, we summed the numbers 1, 2, 4, and 9, which equals 16. Then we calculated percentages of each figure to the sum: 1/16, 2/16, 4/16, and 9/16. (These are 6%, 13%, 25%, and 56%.) We interpolated expected tax reported each year by applying these percentages to the additional $6 million per year expected with a three-year statute of limitations, then added this figure to the $2.0 million in tax reported under current law. For example, with a four-year statute of limitations, we would expect 56 percent of $6 million ($3.4 million) plus $2.0 million, for a total of $5.4 million, as shown in the table. For a five-year statute of limitations period, we made the same set of calculations, only substituting 25 percent for 56 percent. For the sixth and seventh years we used 13 percent and 6 percent, respectively.