



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/14/02	Bill No:	AB 1977
Tax:	Sales and Use	Author:	Strickland
Board Position:		Related Bills:	AB 2056 (Zettel)

BILL SUMMARY

This bill would provide an annual six percent sales tax exemption for the first \$1,000 from the sale of any home or laptop computer sold during Labor Day weekend.

ANALYSIS

Current Law

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted.

Under current law, sales of computers are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute. The rate of tax currently applicable to retail sales of computers and related equipment is made up of various components:

- 5 percent state tax allocated to the state's General Fund (Section 6051, 6051.3, 6201 and 6201.3).
- 1/2 percent state tax allocated to the Local Revenue Fund which is dedicated to local government for program realignment (Section 6051.2 and Section 6201.2)
- 1/2 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Sec. 35 of Article XIII of the California Constitution).
- 1 1/4 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- 1/8 to 1 1/4 percent Transactions and Use Tax which is allocated to special taxing jurisdictions in various counties and cities within the state (Part 1.6, commencing with Section 7252).

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Proposed Law

This bill would add Sections 6397 to the Sales and Use Tax Law to provide a 6 percent sales tax exemption for the first \$1,000 from the sale of any home or laptop computer for a three-day period beginning at 12:01 a.m. on either the last Saturday in August or the first Saturday in September, and ending at 12:00 midnight on the first Monday in September (Labor Day weekend).

This bill would specify that the exemption *shall not apply* to the taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law or the Transactions and Use Tax Law.

The bill would become effective immediately.

Background

The state of New York started the first “sales tax holiday” in 1997. That measure was prompted by the competitive disadvantage New York had with the neighboring state of New Jersey. Since sales of clothing and footwear were exempt from sales tax in New Jersey, many residents of New York went to New Jersey to purchase their clothes. To help discourage this, New York implemented a law to allow for a one-week exemption from the tax for the sales of clothing valued under \$100. New York was pleased with the results, so it added two additional one-week exemption periods in 1998 and also raised the limit from \$100 to \$500. New York again had the two, one-week exemption periods during 1999, and a permanent exemption for sales of clothing under \$500 became effective in 2000. Currently, the states of Pennsylvania and South Carolina have an annual sales tax holiday for the purchase of computers and related products. The states of Connecticut, Florida, Iowa, Maryland, and Texas all have some form of annual sales tax holiday for back-to-school purchases.

Two California “sales tax holiday” measures were considered during the 1999-00 Legislation Session, and two in the 2001 Session. Assembly Bill 944 (Cardenas), in its last amended form, would have provided an exemption for clothing and footwear purchased for \$100 or less during a 3 day period, and Assembly Bill 1320 (Ashburn) proposed a one-week exemption from the sales tax on purchases of any tangible personal property for less than \$500. AB 944 was held in the Senate Revenue and Taxation Committee, and AB 1320 failed to pass from its house of origin by the deadline. The Board’s position was “neutral” on both measures.

During the 2001 Session, AB 1185 (Mountjoy) would have provided an ongoing partial sales tax exemption of 6 percent for the sale of any article of clothing or footwear sold for \$200 or less for a 7-day period ending every last Thursday in August. And, AB 1199 (Cardenas, et al.), sponsored by the Governor, would have provided a sales tax exemption for the sale of any article of clothing or footwear for \$200 or less, and any computer and related accessories, as specified, sold for \$1,000 or less, during a three-day period in August 2001. AB 1199 also specified that unless the governing body of a city, county or district votes to not have the sales tax holiday apply to its respective local tax, the holiday would additionally apply to those taxes. The Board voted to support both these measures.

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COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in an effort to provide an opportunity for consumers to purchase computers at a considerable savings. The author's office notes that this savings can help get technology into the hands of people who most need it and bridge the "digital divide" that is evident in many communities. A recent survey indicates that 46 percent of American households do not have a personal computer.
2. **Definitions of qualifying property should be included.** The bill does not define "home computers and laptops." In order for the Board to properly administer the exemption and to eliminate confusion for computer retailers, the bill should incorporate a definition of exactly the sort of home computer the author intends to be included. In addition, any related accessories that the author may wish to include within the proposed exemption, such as printers, scanners, ink cartridges, software, etc. should also be itemized within the language.
3. **Exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. As an example, if a customer purchases an Apple computer and exchanges the Apple for a Macintosh computer, the transaction is regarded under the law as a separate sale of the Macintosh and a rescission of the original sale of the Apple. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the Board, the sales price of the Apple, and is also required to include in his or her taxable sales amount, the sales price of the Macintosh. Using this example under the proposed holiday period, if the Apple computer is purchased during the sales tax holiday period, and is exchanged for the Macintosh *after* the holiday period, the proposed exemption would not apply to the exchange of the Macintosh since that transaction is recognized under the law as having occurred after the exempt holiday period. This may result in reporting errors by retailers and added confusion and inquiries by customers.

Another source of confusion could result from the use of rain checks. Current law also provides that a rain check issued by a retailer does not constitute a sale of tangible personal property. Therefore, if a retailer is out of stock of a particular item and issues a rain check to the customer during the holiday period, and the customer subsequently uses the rain check to purchase the out of stock item after the proposed holiday period, the exemption would not apply.

4. **A 3-day exemption could increase retailers' costs.** Creating an exemption that only lasts for three days would place an additional burden on retailers to have their cash registers programmed to tax sales on certain dates and not tax sales on other dates. This may require retailers to incur costly and frequent reprogramming of their registers to accommodate the change. Retailers would presumably be compensated for this by increased sales activity during the exempt period.

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Based on information in a 1990 report that the Board prepared to determine the impact on retailer's costs with respect to implementing a tax increase in 1989, on average, retailers with quarterly prepay accounts spent \$94.35 to reprogram their cash registers and computers and retailers with monthly and quarterly accounts paid \$19.47. Adjusting these figures for an increase in the California Consumer Price Index and the increase in the number of accounts since the 1990 study, it is estimated that retailers incur approximately \$9.3 million in comparable reprogramming costs to implement a rate change.

5. **Exemption applies to sales tax only.** The proposed law would exempt sales of computers from the computation of the sales tax, but not the use tax. Therefore, California consumers ordering computers from out-of-state via the Internet or mail order, for example, would continue to remain liable for the use tax during the holiday period. There could be a constitutional concern with this under the Commerce Clause of the United States Constitution. It could be argued that allowing an exemption for in-state purchases while applying use tax to out-of-state purchases discriminates against interstate commerce.
6. **Related legislation.** AB 2056 (Zettel) would provide an annual one-day state and local sales and use tax exemption on the third Saturday of August for the sale of qualified personal computer products, as defined.

COST ESTIMATE

Administrative costs would be incurred in preparing and mailing a special notice to affected retailers, creating and distributing new sales tax charts to affected retailers, and answering potentially numerous inquiries. Because of the potential for a partial tax exemption with varying local tax rates, administrative costs would also be incurred in computer programming, return revision, return analysis, and return processing. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill will exempt certain sales of computers from the 5% state Sales and Use Tax and from the 0.5% Local Revenue Fund and the 0.5% Local Public Safety Fund. Excluded from this proposed exemption is the Bradley-Burns Uniform Local Sales and Use Tax and the Transactions and Use Tax.

The bill would exempt home or laptop computers. We assume that this would cover all desktop, personal computers and laptops.

According to a study by DataQuest, 6,425,000 desktop and laptop computers were sold in California in 1999. During the years 2000 and 2001, International Data Corporation estimated an annual 10% decline in national sales of desktop and laptop computers. Applying this decline to California sales, an estimated 5,204,000 desktop and laptop computers were sold in California during 2001.

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It is estimated that desktop computers costing less than \$1,000 represented 20% of the sales or 1,040,800 units (5,204,000 times 20%). At an average price of \$900, the annual sales of these computers is estimated to be \$0.9 billion. The remaining desktop and laptop computers were sold for \$1,000 or more. This amounts to 4,163,200 units (5,204,000 times 80%). The exempt amount on these sales would be \$4.2 billion.

The total gross receipts for the first \$1,000 sales of desktop and laptop computers during 2001 is estimated at \$5.1 billion.

We would expect sales of desktop and laptop computers to be higher than average for the periods when these sales would be exempt from the sales tax. The state of Texas found that during a week's tax holiday on clothing and footwear, sales were double the normal weekly sales. Based on this information, we assume that the three-day period involved represents six days worth of sales in a year. Therefore, the estimated total sales of desktop and laptop computers in California during the three-day period would be \$83.8 million. This figure was calculated as follows:

$$(6 / 365 \text{ days in the year }) \times \$5.1 \text{ billion} = \$83.8 \text{ million.}$$

Revenue Summary

The revenue loss from the exempting of home and laptop computers for three days from sales and use tax would be as follows:

	Revenue Loss (in millions)
State General Fund loss (5%)	\$ 4.2
Local Revenue Fund loss (0.05%)	0.4
Public Safety Fund loss (0.05%)	<u>0.4</u>
Total	\$ 5.0

Analysis prepared by:	Sheila T. Sarem	445-6579	03/15/02
Revenue estimate by:	David E. Hayes	445-0840	
Contact:	Margaret S. Shedd	322-2376	

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