



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/22/06	Bill No:	AB 2320
Tax:	Sales and Use	Author:	La Malfa
Related Bills:			

BILL SUMMARY

This bill would specify that the “gross receipts” and “sales price” from the retail sale of a wireless communication device (device), as defined, is limited to the amount charged for the sale of that device when that device is sold in a bundled transaction, as defined.

ANALYSIS

Current Law

Under existing law, the sales tax is imposed on the gross receipts from the sale of tangible personal property, unless specifically exempted by law. “Gross receipts” and “sales price” are terms defined in the law meaning the total amount of the sale or lease or rental price, without any deduction on account of the cost of materials used, labor or service costs, interest charged, losses, or any other expenses related to the sale of the property. Normally, a service that is sold in connection with a taxable sale of tangible personal property is regarded as part of the sale, and therefore subject to tax on the receipts derived from the sale of that service.

However, due to the marketing and retail pricing strategies that contradicted conventional and customary retail practices of the wireless telecommunications industry, the Board in 1999 adopted existing Regulation 1585, *Cellular Telephones, Pagers, and other Wireless Telecommunications Devices*, to specifically address the application of sales and use tax in connection with these devices and related charges for services.

Under the regulation, the amount upon which tax is computed is generally dependent upon whether the device was sold in a “bundled” or “unbundled” transaction. “Bundled” transactions are defined in the regulation as those sales in which the customer is required to activate or contract for utility service with a wireless telecommunications service provider for a period greater than one month as a condition of the sale. Generally, in order for customers to receive the promotional or discounted sales price of the devices, they must agree to activate or sign up for utility service with a provider for more than a one-month period. Under the regulation, generally, the retailer is required to compute tax on the sale of the device based on the “unbundled sales price.”

The “unbundled sales price” is defined in the regulation as the price at which the retailer has sold specific types of devices to customers who are not required to activate or contract for utility service as a condition of the sale. If the retailer has not previously sold a specific device in other than a bundled transaction, the unbundled sales price is equal to the fair retail selling price of the device.

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.

If the sale is unbundled (the customer is not required to activate or contract for utility service as a condition of the sale), the tax applies to the actual gross receipts from the sale of the device to the customer.

Proposed Law

This bill would add Section 6012.4 to the Sales and Use Tax Law to provide that the terms “gross receipts” and “sales price” from the retail sale of a wireless communication device, as defined, shall be limited to the amount charged for the sale of the device when it is sold in a bundled transaction, as defined.

The bill would define “bundled transaction,” “wireless telecommunications device,” and “wireless telecommunications provider.”

As a tax levy, the bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill is enacted.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. Its intent is to minimize the confusion experienced by consumers over the amount of tax retailers are charging in connection with their purchases of cell phones and other wireless devices. The author’s office believes that only the specific amount charged for the sale of the device should be the amount upon which tax is computed.
2. **It is unclear how tax would apply in situations where the device is given free of charge.** Under the current regulation applicable to these devices, generally, when a device is given away free of charge on the condition that the customer is required to activate or contract for utility service, the retailer is required to compute the tax based on the “unbundled sales price” (the price at which the retailer has sold the specific device to customers who were not required to activate or contract for utility service as a condition of the sale). It is unclear under the provisions of this bill whether any tax would be due on such transactions.

Generally, other than transactions involving wireless communication devices, in situations in which a retailer sells other types of tangible personal property at a price substantially less than his or her cost, or makes no charge for the property, the retailer is liable for tax based on his or her cost. The retailer in such situations may not collect tax reimbursement from his or her customers.

Perhaps the bill should be amended to require retailers to pay tax on their cost in situations in which a retailer gives away or charges a nominal amount for the device. Staff will work with the author’s office to address this issue as the bill progresses.

3. **Enactment of this measure would lessen the confusion among purchasers.** Because purchasers are generally accustomed to paying sales tax reimbursement to retailers based on the purchase price of goods they buy, the Board receives a number of inquiries from purchasers regarding the amount of sales tax they were charged in connection with contracts involving purchases of cellular phones and other wireless devices. Enactment of this measure would minimize those inquiries.

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COST ESTIMATE

The Board would incur minor costs to administer this measure. These costs would be attributable to, among other things, identifying and notifying affected retailers of these devices, verifying claimed deductions, and revising the Board’s Regulation 1585. An estimate of these costs is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

According to the Telecommunications Association (TIA), in 2005 the wireless handset and device market totaled \$15 billion in the U.S. The wireless device market is expected to grow to \$17.8 billion in 2006. Wireless handsets comprise 94% of the total wireless device market and reached \$14 billion in 2005.

TIA estimates that the average sales price of a handset in 2004 was \$137, as new features are added; this amount is expected to increase by an average of 3.5% a year, to \$156 in 2008. According to JD Powers and Associates, the average purchase price consumers paid for handsets in 2005 amounted to \$89. Therefore, in 2005 the average purchase price for a handset amounted to 63% of the average sales price (\$89 / \$137x1.035). For the purpose of this estimate we assume that the average purchase price for pagers and PDAs are 63% of the sales price on those devices. The revenue impact of this measure is as follows:

	2006
	(in thousands)
U.S. Wireless Market	
Cell Phones	\$ 16,600,000
Other devices	1,200,000
Total US Market	<u>\$ 17,800,000</u>
California Sales (12% of U.S.)	\$ 2,136,000
Proposed Taxable Measure (63% of California Sales)	1,345,680
Adjustment to taxable measure	<u>\$ 790,320</u>
Estimated State and Local Revenue Loss (7.93%):	<u><u>\$ 62,672</u></u>

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Revenue Summary

This bill would reduce annual sales and use tax revenue by \$62.7 million.

	Revenue Loss (in millions)	
State (5.25%)	\$	41.5
Local (2.00 %)		15.8
District (.63%)		5.4
	\$	62.7

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	04/05/06
Revenue estimate by:	Bill Benson	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

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