STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**03/29/05**	Bill No:	**SB 801**
Tax:	**Sales and Use Tax**	Author:	**Simitian**
Related Bills:			

BILL SUMMARY

This bill would require a retailer that has only one retail location in this state with an estimated measure of tax of less than $17,000 per month to file a sales and use tax return on a calendar year basis and to make quarterly prepayments, as specified.

Summary of Amendments

The introduced version of this bill allowed the retailer *to make an election* to file a sales and use tax return on a calendar year basis with quarterly prepayments.

ANALYSIS

Current Law

In general, under existing law, sales and use taxes are due and payable to the state on a quarterly basis, no later than the last day of the month following the end of the quarter. For example, applicable tax on sales made between January 1 through March 31 must be remitted to the Board on or before April 30.

Under existing law, taxpayers may be required, upon notification by the Board, to file returns on a monthly, calendar year, or fiscal year basis. The Board has established guidelines for placing taxpayers on a monthly, calendar year, or a fiscal year basis. If a taxpayer has a prior history of late payments and other collection problems, and the taxpayer's estimated sales and use tax is between $301 to $1,200 per month, a taxpayer may be placed on a monthly basis. If a taxpayer's estimated sales and use tax is between $0 to $100 per month, a taxpayer may be placed on an annual reporting basis.

If a taxpayer's estimated measure of tax liability averages $17,000 or more per month, the taxpayer is required to report his or her tax liability on a quarterly basis, with two prepayments required within each quarter. For the first, third, and fourth calendar quarters, the first prepayment is due on or before the 24^{th} day of the month following the first month of the quarter. The second prepayment is due on or before the 24^{th} day of the month following the second month of the quarter.

For those required to make prepayments, they must pay not less than 90 percent of the their combined state and local sales and use tax liability for that month. For example, in the first quarter, 90 percent of January's tax liability is due by February 24, and 90 percent of February's tax liability is due by March 24. There is no prepayment for the last month of the quarter, because the tax liability for March, plus the remaining 10 percent tax liability for January and February, is due by April 30.

Alternatively, a taxpayer may elect to estimate their quarterly prepayment. If the taxpayer or their predecessor was engaged in the same business during all of the corresponding quarterly periods of the preceding year, they can make prepayments of one-third of the amount subject to tax for that same quarter in the previous year multiplied by the current tax rate.

Different requirements apply to the second calendar quarter in order to accelerate the collection of tax revenue before the start of the new fiscal year on July 1. For the second quarter, the first prepayment is due on or May 24, like other prepayment months. However, the second prepayment, due on or before June 24, is for the period of May 1 through June 15 and must be one of the following amounts: (1) an amount equal to 135 percent of the tax liability for May; (2) equal to 90 percent of the tax liability for May plus 90 percent of the tax liability for the first 15 days of June; or (3) not less than one-half of the measure of tax liability reported for the corresponding quarterly period of the preceding year multiplied by the tax rate in effect when prepayment is made, provided the taxpayer or their predecessor was in business during all of the quarter.

Proposed Law

This bill adds Sections 6452.2 and 6471.1 to the Sales and Use Tax Law to require a retailer, as specified, to file a sales and use tax return on a calendar year basis and to make quarterly prepayments. The provisions of this bill would apply to a retailer that meets all of the following conditions: (1) the retailer's estimated measure of tax averages not less than $1,400 and not more than $16,999 per month; (2) the retailer has only one business location in this state that is engaged in making retail sales of tangible personal property; and (3) the retailer was engaged in the same business during the entire preceding calendar year, or the retailer was a successor to a business that was in operation during the entire preceding calendar year.

Specifically, this bill would:

- Require a retailer, as specified above, to file a sales and use tax return on a calendar year basis within one month following the close of each calendar year. Returns would be in a form as prescribed by the Board.
- Require the specified retailer to make quarterly prepayments, as described.
- Require the specified retailer that was engaged in the same business during the entire preceding calendar year, to make quarterly prepayments on or before the last day of the month following each calendar quarter.
- Provides that the quarterly prepayments be in an amount equal to the gross receipts for the corresponding calendar quarter in the previous year, multiplied by the state and local tax rate in effect during the calendar quarter for which the prepayment is made.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. According to the author's staff, at a meeting titled "Ought to be a Law," several constitutents stated that it would be much easier and save time to file an annual tax return and make quarterly prepayments. The constituents stated that the sales and use tax return is complicated and time-consuming to fill out. It would be much easier if they could file a return once a year, but make quarterly prepayments and pay the taxes due.

2. **Summary of amendments.** The **March 29, 2005 amendments** *require* a retailer who has only one location in this state that has an estimated monthly measure of tax of not less than $1,400 and not more than $16,999, to file a sales and use tax return on a calendar year basis and to make quarterly prepayments. Under the introduced version of the bill, these provisions were voluntary.

3. **Retailers affected by this bill.** This bill would apply to retailers that meet both of the following conditions: (1) generate an estimated monthly measure of tax of not less than $1,400 and not more than $16,999 per month; and (2) have only one retail location in California. It should be noted that the threshold amounts in this bill of $1,400 and $16,999 are taxable sales, not tax. If we were to convert taxable sales to tax, using a total tax rate of 7.25 percent, the amount of tax would be $101 ($1,400 X 7.25%) and $1,232 ($16,999 X 7.25%).

   Currently, there are 35,000 businesses that file on a quarterly basis with no prepayment requirement. Additionally, there are approximately 109,000 businesses that file an easy "EZ" return because all their sales are in the same taxing jurisdiction and they only claim a few deductions.

   Some of these 144,000 accounts (35,000 + 109,000 could have more than one retail location. However, Board staff believes that the majority of these accounts have only one selling location.

4. **Technical amendments necessary.** Board staff recommends that the following three technical amendments be made:

   <u>Prepayment penalty.</u> As previously stated, businesses with average monthly taxable sales of $17,000 or more generally file on a quarterly basis and are required to make tax prepayments. Retailers who file late tax prepayments are subject to a 6 or 10 percent penalty. If a prepayment is made after the prepayment due date but before the due date for the quarterly return, a 6 percent penalty applies. However, if a retailer makes a tax prepayment after the quarterly due date, a 10 percent penalty applies.

   The prepayment provisions of this bill are not subject to any prepayment penalties. Because a prepayment penalty applies to those retailers filing on a quarterly and prepayment filing basis, for consistency, the same penalties should apply to the prepayment provisions in this bill.

   <u>Allow prepayment amounts to be based on current year information as well as prior year information.</u> This bill also provides that the quarterly prepayment be in an amount equal to the gross receipts for the corresponding calendar quarter in the

previous year, multiplied by the state and local tax rate in effect during the calendar quarter for which the prepayment is made. Under current law, businesses required to file on a quarterly and prepayment filing basis may report a prepayment amount based on the tax liability for the current year period or based on the measure of tax liability reported for the corresponding quarterly period of the previous year multiplied by the tax rate in effect when the prepayment is made. Since the current prepayment filing requirements allow retailers an option of reporting either current or prior year information, the same option should be allowed in this bill.

Security. For each tax program administered by the Board, the Board is required or authorized under law to obtain security, under certain conditions, to ensure payment of any tax that might become due or delinquent. In determining whether or not security is necessary to protect the interests of the State, the Board looks at a number of factors such as payment history and the financial condition of the business. Section 6701 of the Sales and Use Tax Law provides for security limits for quarterly and monthly filers.

The retailers described in this bill are currently subject to the security requirements because they either file on a quarterly or monthly basis. However, because Section 6701 applies only to quarterly and monthly filers, the retailers described in this bill would no longer be subject to such security requirements. Also, with retailers filing on a calendar year basis, the collection of underreported or unpaid prepayments could prove to be more problematic, increasing the potential for loss. Board staff recommends that the retailers described under this bill be subject to the security requirements under Section 6701.

Board staff is willing to work with the author's office in drafting any amendments.

5. **Prepayment forms are easier to process than sales and use tax returns.** On a prepayment form, there are only two lines of information that need completing. On a sales and use tax return, there are over 25 lines of information that must be filled out, in addition to completing any supplemental schedules for the allocation of local and district taxes. Consequently, it takes a lot less time to key in a prepayment form than it does to key in a sales and use tax return and any local and district tax schedules.

6. **Allocations of local and district tax.** As previously stated, the prepayment form has only two lines of information: the total amount of tax (state, local, and district) and penalty (6% penalty applies if tax prepayment or prepayment form is filed after the due date). Because the amount of tax reported on the prepayment form is a combined amount, the Board will not know the actual allocation of local and district taxes until the taxpayer files their sales and use tax return. For quarterly and prepayment filers, the Board does not allocate the local and district taxes until it receives the taxpayer's quarterly sales and use tax return. The Board's computer system is designed to allocate from the sales and use tax return, and, in order to allocate the revenues to the individual jurisdictions, must have both the taxable measure amount, as well as the amount of county, local, and district tax.

   Additionally, the provisions of this bill apply to retailers with only one retail location in California. As such, many of these retailers are not required to file a Schedule C –

Detailed Allocation By Suboutlet of Uniform Local Sales and Use Tax. However, if the retailer is a "special seller," such as a vending machine operator or a construction contractor, the retailer could be required to file a Schedule B – *Detailed Allocation By County of Combined State and Uniform Local Sales and Use Tax.* Additionally, the retailer could possibly be engaged in business in various special taxing districts and required to collect the district tax for those areas. For example, retailers using their own delivery vehicles to deliver merchandise into a district, must collect the applicable district tax for that special tax district. The Board allocates the district tax based on the retailer's Schedule A – *Computation Schedule For District Tax.* The Schedule A provides a breakdown of the district tax to the various special district tax areas.

As previously stated, the Board will not know the actual allocation of local and district taxes until the taxpayer files their sales and use tax return along with their district tax schedule. Consequently, the local and district taxes will be distributed to the local jurisdictions on a calendar year basis, rather than a quarterly basis.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers, revising forms and publications, programming, and answering inquiries from the public. A cost estimate is pending.

REVENUE ESTIMATE

This bill would not impact state's revenues. However, to the extent that the retailer's tax liability for the corresponding quarterly period for the previous year is more or less than the current year quarterly period, there may be an increase or decrease in the amount of tax reported on the prepayment form. For example, if a taxpayer's tax liability for the second quarter 2005 is $250, but the taxpayer's tax liability for the second quarter 2006 is $350, the amount reported for the quarterly prepayment would be $100 less than the actual tax amount for the current year quarter ($350 - $250). This $100 timing difference would be reported and paid at the time the taxpayer files their sales and use tax return at the end of the calendar year.

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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.