STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**06/28/05**	Bill No:	**SB 801**
Tax:	**Sales and Use Tax**	Author:	**Simitian**
Related Bills:			

BILL SUMMARY

This bill would make it voluntary, for a retailer that has only one retail location in this state with an estimated measure of tax of not less than $1,400 and not more than $4,000 per month to file a sales and use tax return on a calendar year basis and to make quarterly prepayments, upon approval by the Board, as specified.

Summary of Amendments

Since the previous analysis, this bill was amended to incorporate Board suggested technical amendments.

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, or the taxpayers' 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 24th day of the month following the first month of the quarter. The second prepayment is due on or before the 24th 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 amends Sections 6478, 6592, 6592.5, and 6701 of, and adds Sections 6452.2, 6471.1, 6476.1, 6477.1 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 <u>all</u> of the following conditions:

1) The retailer submits a written request to the Board to file returns pursuant to Section 6452.2 and to make prepayments pursuant to Section 6471.1;
2) The Board approves the retailer's request and issues a written notification to that retailer;
3) The retailer's estimated measure of tax averages not less than $1,400 and not more than $4,000 per month;
4) The retailer has only one business location in this state that is engaged in making retail sales of tangible personal property, and;
5) 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.

This bill would also do the following:

- Provide 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 or would be in an amount equal to the state and local tax liability for the quarterly period for which the prepayment is due.
- Provide that the specified retailer would continue to file returns as required by these sections until otherwise notified by the Board.
- Authorize the Board, if it deems necessary for efficient administration, by written notice, require any retailer filing a return pursuant to Section 6452.2, to file quarterly returns pursuant to Section 6452.
- Prohibit any person required to make prepayments pursuant to Article 1.5 (Section 6480) or to any other person for which the Board determines that the remittance of prepayments pursuant to Section 6471.1 would not be in the best interests of the state.
- Impose a 6 percent penalty for failure to file a timely prepayment.
- Impose a 10 percent penalty if the failure to make a prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or Board regulations.
- Provide for relief from the penalty for failure to make a timely return or payment, if, because of circumstances beyond the retailer's control, a return or tax payment was not made on time.
- Authorize the Board, if it deems necessary to ensure compliance with this part, to require the specified retailer to post security.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. According to the author's staff, at a contest titled "There Oughta 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 **June 28, 2005 amendments**: (1) impose a 6 percent penalty for failure to file a timely prepayment; (2) impose a 10 percent penalty if the Board determines that the prepayment was late as the result of negligence or intentional disregard of the law or Board regulations; and (3) provide relief from penalty charges if, because of circumstances beyond the retailer's control, a return or payment was not made on time. The **May 27, 2005 amendments:** (1) provide that a retailer, as specified, must have an average monthly measure of tax of *not more than $4,000*; (2) require a retailer to submit a written request to the Board to file on a calendar year basis and to make quarterly

prepayments; (3) authorize the Board to approve the retailer's request in writing; (4) provide that, if the Board deems it necessary, may require any retailer filing returns pursuant to Section 6452.2 and making prepayments pursuant to Section 6471.1, to file quarterly returns pursuant to Section 6452; and (5) make nonsubstantive, technical amendments. The **April 20, 2005 amendments** addressed concerns raised in the previous Board staff analysis. These technical amendments are: (1) extend the prepayment penalty application to the retailers described in this bill; (2) provide that the prepayments would be based on amounts reported from the same quarter in the prior calendar year or would be based on *amounts for the current quarterly period for which the prepayment is* due; (3) authorize the Board to require the retailers described in this bill to post security if the Board deems it necessary, as specified; and (4) provide that a retailer described in this bill would continue to file returns as required until otherwise notified by the Board. 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. **It is difficult to determine the number of eligible retailers who would request to file on this new reporting basis.** This bill authorizes a retailer that meets the following conditions to file returns on a calendar year basis and to make quarterly prepayments. Those conditions are: (1) retailer submits a written request to the Board; (2) Board approves retailer's request in writing; (3) retailer's estimated measure of tax would not be less than $1,400 and not more than $4,000; (4) retailer has only one location in this state; and (5) retailer must have been engaged in business during the entire preceding calendar year, or a successor to a business that was in operation during the entire preceding calendar year.

   Using data for the calendar year 2004, Board staff determined a total number of 55,089 eligible retailers that might request to file on this new reporting basis. Board staff determined this number using the following conditions: (1) retailer has an average monthly measure of tax between $1,400 and $4,000; (2) retailer has only one location; (3) retailer was engaged in business during the entire preceding 2004 calendar year; (4) exclude retailer that is required to make sales tax prepayments on motor vehicle fuel (see comment 5); and (5) exclude retailer that filed delinquent returns. This bill would authorize the Board to approve a retailer's request to file on this new reporting basis. The Board's main criterion would be whether a retailer has filed and paid his or her sales and use tax returns on time.

   The following table provides the total number of eligible retailers, including the amount of taxable measure, state tax, Bradley-Burns local tax, and district tax.

Total Eligible Retailers	Total Taxable Measure	*Total State Tax (6 /6.25 percent)	*Total Local Tax (1 /0.75 percent)	Total District Tax
55,089	$1,669,892,255	$102,280,900	$14,611,557	$11,347,913

*AB 9 (Chapter 2, Stats. 2003) enacted the Economic Recovery Bond Act. Operative 7/1/04, the state portion of the sales and use tax rate increased by 0.25 percent and the Bradley-Burns local tax rate decreased by 0.25 percent.

However, the provisions of this bill make it voluntary for retailers to change to this new reporting basis. Some retailers would choose to continue reporting on a quarterly basis. Consequently, it is difficult to determine the number of retailers that would actually change to this new reporting basis. However, **Board staff's best estimate would be that 25 percent of the eligible retailers would request to file returns on an annual basis.** The following table shows the amount of taxable measure, state tax, Bradley-Burns local tax, and district tax using Board staff's estimate of 25 percent:

Total Eligible Retailers	Total Taxable Measure	Total State Tax (6 /6.25 percent)	Total Local Tax (1 /0.75 percent)	Total District Tax
13,772	$417,473,063	$25,570,225	$3,652,889	$2,836,978

4. **A number of eligible retailers' use the Board's easy "EZ" Sales and Use Tax Short Form return.** Many of the eligible retailers in this bill already use an "EZ" return (see attachment) to report their sales and use taxes. The Board designed this return for the purpose of finding an easier way for retailers to report their sales taxes. The return is only one page and contains separate lines for reporting the following information: total sales, purchases subject to use tax, a total of five of the most common exemptions, and the total amount of sales and use tax. A tax rate is printed on the return that is applicable for the retailer's business location.

   In order to file an EZ return, a retailer must have either a single location or multiple locations that share the same master seller's permit number and are in the same local jurisdiction. There are no local or district tax schedules to be filed with an EZ return.

   Because the EZ return is fairly simple to complete, some of the retailers that might be eligible to file on this new annual reporting basis, may choose to keep reporting on a quarterly basis using the EZ return. It should be noted that if a retailer did elect to file on this new annual basis, the retailer might have to file the long form - Sales and Use Tax Return.

5. **Certain retailers would not be allowed to file returns on this new annual reporting basis**. This bill would exclude retailers (e.g., service station operators) required to make prepayments of sales tax on their purchases of motor vehicle fuel. These retailers claim a credit for the precollected sales tax paid to their suppliers on their sales and use tax return. The sales and use tax return includes a Schedule G. To ensure that tax credits have been properly claimed, the Board routinely compares the amounts claimed by retailers on their Schedule G returns to the sales reported on the "SG" returns filed by their suppliers and wholesalers. By excluding this group from filing on an annual basis, the Board can continue to do a quarterly reconciliation of the precollected sales tax on fuel.

   This bill also provides that the Board, if it deems necessary, can exclude other type of retailers from filing on an annual basis. Construction contractors, vending machine operators, and auctioneers who conduct business activities in multiple jurisdictions are required to allocate the local tax among the counties on Schedule B of the sales and use tax return. The Board might consider it in the best interests of the state to exclude these retailers from filing on an annual basis. This way the local taxes would continue to be allocated to the jurisdictions on a quarterly, rather than an annual basis.

6. **If eligible retailer approved to report on new annual basis, Board has authority to change retailer back to quarterly basis.** This bill would authorize the Board, if it deems it necessary for efficient tax administration, by written notice, to change a retailer from an annual to a quarterly reporting basis. In other words, if a retailer was approved to file returns on an annual basis and make quarterly prepayments, but the retailer was not filing and paying his or her prepayments on time, the Board could, in writing, require the retailer to file returns on a quarterly basis.

7. **Board must approve retailer's request.** In approving a retailer's request the Board would look mainly at whether the retailer has filed and paid his or her sales and use tax returns on time. A retailer with a history of delinquencies or accounts receivable more than likely would not be approved.

8. **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.

9. **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, the Board 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 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. However, because the provisions of the bill are voluntary, it is difficult to determine the exact impact on local jurisdictions.

As stated under Comment 3, Board staff estimates that 25 percent of the eligible retailers will request to change to this new reporting basis. In determining the total number of eligible retailers, Board staff also prepared an estimate of the number of eligible retailers for each jurisdiction, including the local tax dollar impact.

Using Board staff's estimate of 25 percent, the **five largest cities** (does not include the City of Los Angeles) had a total number of eligible retailers ranging from 144 to 429. The amount of local tax (rate of 1 percent for first half of 2004 and 0.75 percent for second half of 2004) was between $44,351 and $128,376. The City of Los Angeles had an estimated 1,830 eligible retailers with a total local tax impact of $547,719.

Using Board staff's estimate of 25 percent, the **five medium cities** had a total number of eligible retailers ranging from 103 to 137. The amount of local tax was between $16,671 and $41,137.

Using Board staff's estimate of 25 percent, the **five smallest cities** had a total number of eligible retailers ranging from 1 to 3. The amount of local tax was between $50 and $292.

It should also be noted that there are some cities with zero eligible retailers. Also, many cities have under a 100 eligible retailers.

10. **The retailers in this bill currently would not qualify for E-Filing.** The Board's Sales and Use Tax Electronic Filing (E-Filing) Program is a voluntary program. A retailer's return and payment information is electronically submitted to an authorized service provider who then transmits the information to the Board for processing. Currently, only single-outlet retailers are eligible for E-Filing. The Sales and Use Tax return forms that may be electronically filed are the BOE- 401-A, Long Form return with a Schedule A (District Tax) and Schedule T (Partial Exemption), and a BOE-401 EZ Short Form return.

    There are several types of sales and use tax accounts that are not eligible to participate in the E-Filing Program. Currently, retailers who are required to make monthly estimated prepayments of tax (i.e., quarterly return filers with monthly prepayments) **are not eligible** to participate in the E-Filing Program.

    Because the retailers in this bill would file an annual return and make quarterly prepayments, these retailers **would not be eligible** for participation in the E-Filing program. However, the Board is expanding the eligibility criteria, which would allow retailers to file their prepayment sales and use tax returns using the Internet.

COST ESTIMATE

For the fiscal year 2005-06, the Board would incur start-up costs of approximately $380,000. The start up costs would be for the following functions:

- Programming to create a new reporting basis system—annual account with quarterly prepayments;
- Answering telephone inquiries by the Board's Information Center during peak periods;
- Revision of two existing tax returns including return instructions, creating a new prepayment form, and revision of board publications;
- Processing of approximately 14,000 taxpayer requests to change to the new reporting basis: assignment and review of taxpayer's request, verification of taxpayer's payment history, verification that taxpayer meets statutory requirements (i.e., taxable sales of $1,400 to $4,000, one retail location, and engaged in business for the entire preceding calendar year), preparation of approval or denial letter, review and approval of request package.

The estimated on-going costs to administer would be $193,000 for the fiscal year 2006-07, and annually thereafter. The ongoing costs are related to the following:

- Additional staff needed during the peak periods of January and February for the timely processing of annual returns to ensure that the allocations of local tax dollars are made during the fourth quarter allocation period.
- Monitoring of approximately 14,000 accounts, converting approximately 500 accounts from the new annual basis to a quarterly basis due to taxpayer not filing quarterly prepayments on time, processing of new accounts that request to file on an annual basis and make quarterly prepayments, and monitoring of local tax allocations.

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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