STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**06/18/03**	Bill No:	**SB 1009**
Tax:	**Sales and Use**	Author:	**Alpert**
Board Position:		Related Bills:	**AB 1741 (AR&T)**

BILL SUMMARY

This bill would, for purchases made on or after January 1, 2003, and through December 31, 2009, authorize a person to report qualified use tax on their California income tax return.

Summary of Amendments

Since the previous analysis, amendments to this bill would implement the provisions one year earlier, modify the definition of qualified use tax, require the Franchise Tax Board (FTB) to transfer any information to the Board of Equalization (Board) that the Board deems necessary for the proper administration of the provisions in this bill, and would allow the Board 10 working days to approve the returns submitted by the FTB for the purpose of collecting qualified use tax.

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 of Equalization (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.

The Board is the state agency responsible for administering the provisions of the use tax. The Franchise Tax Board (FTB) is responsible for administering the personal income tax and the corporate franchise tax. For many years, the FTB has included in the personal income tax booklet instructions for paying California use tax. In an effort to make reporting use tax more convenient for the public, and to further educate California residents of their possible use tax reporting requirements, the Board made arrangements with the FTB to insert a California Individual Use Tax Return into the center of the 2002 personal income tax booklets that were mailed to taxpayers and made available in public areas.

Proposed Law

This bill would amend Section 6487 and 7101 of, and add Sections 6452.1 and 6487.3 to, the Sales and Use Tax Law which would provide that every person that purchases tangible personal property which is subject to the qualified use tax may elect to report qualified use tax on an acceptable tax return.

This bill would define the term "acceptable tax return" to mean a timely filed original return that is filed pursuant to Article 1 (commencing with Section 18501), Article 2 (commencing with Section 18601), Section 18633, Section 18633.5 of Chapter 2 of Part 10.2, or Article 3 (commencing with Section 23771) of Chapter 4 of Part 11. The referenced sections pertain to returns filed by individuals, fiduciaries, banks, corporations, partnerships, limited liability companies, and exempt organizations.

This bill would define the term "qualified use tax" to mean the use tax imposed under the Sales and Use Tax Law, the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), that has not been paid to a retailer holding a seller's permit or certificate of registration-use tax. "Qualified use tax" would not include any of the following:

- Use tax that applies to a mobilehome or a commercial coach that is required to be registered annually pursuant to the Health and Safety Code.
- Use tax that applies to a vehicle subject to identification under Division 16.5 (commencing with Section 38000) of the Vehicle Code (off-highway vehicles).
- Use tax that would apply to a vehicle that qualifies under the permanent trailer identification plate program pursuant to subdivision (a) of Section 5014.1 of the Vehicle Code.
- Use tax imposed on a vehicle, vessel or aircraft.
- Use tax imposed on a lessee of tangible personal property.

This bill provides that the provisions in this bill would not apply to any person who is otherwise required to hold a seller's permit or to register with the Board pursuant to existing sales and use tax laws.

This bill would provide that in the case of a married individual filing a separate California personal income tax return, an election may be made to report either one-half of the qualified use tax or the entire qualified use tax on his or her separate California personal income tax return. If an individual elects to report one-half of the qualified use tax, that election will not be binding with respect to the remaining one-half of the qualified use tax owed by that individual and that individual's spouse.

This bill would require that if a person elects to report qualified use tax on an acceptable tax return, that person shall comply with all of the following:

- The qualified use tax shall be reported on and remitted with an acceptable tax return.
- The qualified use tax shall be reported on and remitted with an acceptable tax return that is required to be filed for the taxable year in which the liability for the qualified use tax was incurred.

This bill would provide the following provisions for the purpose of administering the qualified use tax:

- Penalties and interest would apply in accordance with existing sales and use tax laws.
- Any claims for refund for qualified use tax shall be made in accordance with existing sales and use tax laws regarding overpayments and refunds.
- Qualified use tax would be considered to be timely reported and remitted provided the qualified use tax is timely reported on and remitted with an acceptable tax return.
- The Board would not be precluded from making any determinations for understatements of qualified use tax in accordance with existing sales and use tax laws.
- The statute of limitations with respect to qualified use tax reported shall be three years after the last day for which an acceptable tax return is due or filed, whichever occurs later.
- In the event of gross understatement of qualified use tax, the statute of limitations shall be six years after the last day for which an acceptable tax return is due or filed, whichever occurs later.
- The FTB would revise the returns in a form and manner approved by the Board for the purpose of allowing a person to report and pay qualified use tax. The Board would be allowed 10 working days to approve the returns submitted by the FTB.
- The FTB would be required to transfer the qualified use tax received pursuant to the provisions in this bill to the Board within 60 days from the date the qualified use tax is received by the FTB. The FTB would also be required to transfer any information the Board deems necessary for the proper administration of the use tax.
- If a person elects to report qualified use tax on an acceptable tax return, any payments and credits shown on an acceptable tax return, together with any other credits associated with that person's account, would be applied in the following order:
  1. State income tax.
  2. Penalties and interest, if any, on the state income tax.
  3. Qualified use tax.

The provisions in this bill would apply to purchases of tangible personal property made on or after January 1, 2003, and on or before December 31, 2009.

Background

The collection of use tax relies heavily on the voluntary compliance of purchasers of tangible personal property. However, due to the general misconception that purchases from outside this state are "tax free" and the insufficient audit resources to go after all purchasers, the voluntary compliance rate has been very low. Ex-tax purchases from out of state retailers is regularly the largest area of non-compliance the Board's audit staff encounters. That is why the Board has sought other avenues to attempt to increase use tax compliance, including publishing instructions for reporting use tax in the personal income tax booklet distributed by the FTB.

On June 25, the Board voted to adopt a joint effort between the Board and the FTB to include a line on the personal income tax return asking if the taxpayer has made any purchases from outside this state without payment of tax. Unlike the provisions in this bill, this proposal would not require reporting of the tax on the personal income tax return, but would instead instruct the taxpayer to complete the individual use tax return and mail payment to the Board. Since use tax is normally due and payable to the Board on the last day of the month following the quarterly period in which the liability arose, the Board instructed staff to seek legislation to address the issue of use tax not being reported and remitted on a timely basis when reported at the time of filing an income tax return.

Several other states have taken the step of including a use tax line on the state income tax return. The most recent examples are Ohio and Michigan. Ohio first had a use tax line in 2000. Use tax receipts prior to adding the use tax line were minimal. Use tax receipts after addition of the use tax line were approximately $1.7 million, with slightly less than 1 percent of all taxpayers reporting use tax. Michigan added a use tax line in 1999. Use tax receipts prior to adding the use tax line were approximately $240,000 per year. Use tax receipts after the addition of the use tax line were approximately $2.9 million, with about 1.5 percent of all taxpayers reporting the use tax.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author in an effort to increase use tax compliance.
2. **Key amendments. June 18** amendments modified the definition of qualified use tax, would require the FTB to transfer any information to the Board that the Board deems necessary for the proper administration of the provisions in this bill, would allow the Board 10 working days to approve the returns submitted by the FTB for the purpose of collecting qualified use tax, and provided that the provisions of this bill would apply to purchases made on or after January 1, 2003. **June 3** amendments modified the definition of qualified use tax, removed the provision requiring the Board to reimburse the FTB for costs incurred to implement and administer the provisions of this bill, and made other technical amendments suggested by the Board. **May 12** amendments excluded existing permit holders from reporting qualified use tax on an income tax return, expanded the provisions to allow corporations, partnerships, and limited liability companies to report qualified use tax, removed the $400 use tax threshold, provided that interest and penalty provisions on qualified use tax shall be in accordance with existing sales and use tax laws, provided that qualified use tax is deemed to be filed timely provided it is reported on and remitted with a timely filed income tax return, and provided that the Board shall reimburse the FTB for costs incurred to implement and administer the provisions of this bill. **April 22** amendments removed provisions related to state employee compensation and inserted provisions authorizing an individual to report qualified use tax on their California personal income tax return.
3. **Purchase dates.** The provisions in this bill would apply to purchases of tangible personal property made on or after January 1, 2003. Personal income tax returns for this period would most likely not be filed until after January 1, 2004.

4. **Tax administration.** This bill would require the FTB to remit the qualified use tax received to the Board within 60 days from the date the tax is received. The FTB would also be required to transfer any information the Board deems necessary for the proper administration of the use tax. In order to properly administer the local tax and district tax laws, the Board would need to obtain the name and address for each taxpayer so the Board may properly allocate local and district taxes. Name, address, and social security number information would also be necessary for situations when the qualified use tax is reported but not remitted and the Board must collect on the delinquent amount.

5. **Gross understatement of qualified use tax.** This bill would provide that if an individual reports an amount that is deemed to be a gross understatement of qualified use tax on his or her personal income tax return, the statute of limitations would be extended from three years to six years. This bill would define the term "gross understatement of qualified use tax" to mean a deficiency that is in excess of 25 percent of the amount of qualified use tax reported on the personal income tax return.

6. **Get the word out.** Collecting qualified use tax would rely to a great extent on voluntary compliance. For the provisions of this bill to be most successful, the public must be made aware of the qualified use tax. Working with the tax professional community and the tax preparation software industry could result in more individuals being made aware of use tax liabilities.

7. **Related legislation.** Assembly Bill 1741 (Assembly Revenue and Taxation Committee) would limit the period in which the Board may assess unpaid use taxes for qualified California purchasers that voluntarily self-report their use tax obligations to 3 years. This Board-sponsored bill is 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.

COST ESTIMATE

Costs would be incurred in programming, notifying taxpayers, answering inquiries, writing appropriate regulations, updating forms and publications, allocating the tax, processing refund claims, and performing internal accounting functions. Board staff identified total costs exceeding $3 million for the above tasks. FTB staff identified costs of $1.8 million to implement and administer the provisions in this bill that would fall within the responsibility of the FTB.

The Budget Conference Committee has approved $2.228 million for the Board's 2003-04 fiscal year budget to cover the costs associated with implementing and administering the provisions of this bill. Of this amount, the Board would be required to reimburse the FTB $1.062 million to cover the FTB's costs associated with implementing and administering the provisions of this bill that fall within the responsibility of the FTB. The remaining $1.166 million would cover the Board's personal services costs associated with implementing and administering the provisions of this bill.

The inclusion of these funds in the Board's 2003-04 fiscal year budget are dependent on successful passage of this bill (or similar provisions that may be amended into another bill). If the bill is enacted, the Board and FTB would not know the true costs of the bill until the upcoming tax year ends and taxpayers file their tax returns under the provisions in this bill.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Personal Income Taxpayers. Last year we estimated that the total use tax revenue loss related to remote sales (mail order and electronic commerce sales) from out-of-state vendors to California households was $456 million; $309 million in mail order sales and $147 in electronic commerce sales. (These revenue estimates assume a total statewide average tax rate of 7.92 percent, and are documented in a revenue estimate, “Electronic Commerce and Mail Order Sales,” April 12, 2002.) These figures are based on U.S. Census Bureau data through 2001. The 2002 data from the U.S. Bureau of Census data would indicate little change in the $456 million figure. The more recent Census data show that in 2002 U.S. Internet sales increased but mail order sales declined, resulting in little change in the total U.S. remote sales figure.

Results from a 2002 Federation of Tax Administrators (FTA) survey show that 13 states have a line that enables taxpayers to declare use tax liabilities on their state personal income tax forms. Of these 13 states, 10 states provided data on numbers of returns filed and total use tax liabilities. No data were provided for total numbers of personal income tax filers for these states. The use tax rates vary from 4.2 to 6.0 percent for the states for which we have data.

We obtained population figures from the U.S. Census Bureau for the 10 states for which we had data. Then we calculated the number of returns divided by population to determine a participation rate. The average participation rate (weighted by population) for these 10 states was 0.6 percent. U.S. adult population is about 74 percent of total population. (California adult population is a similar percentage, about 73 percent of total population.) An adult participation rate for the 10 states could be approximated by dividing the participation rate of 0.6 percent by the adult population percentage of 74 percent. This calculation yields an adult participation rate of approximately 0.8 percent (0.6 / 0.74 = 0.8). Based on these facts, it would seem reasonable to assume that approximately one percent of unpaid use tax liabilities (a rounding off of the 0.8 percent figure) would be reported by having a line on the personal income tax form. One percent of $456 million is approximately $5 million.

Business Income Taxpayers. In 2002, we estimated the electronic commerce use tax revenue loss to be $783 million from out-of-state businesses to California businesses. (These revenue estimates are documented in a revenue estimate, “Electronic Commerce and Mail Order Sales,” April 12, 2002.) As was the case with consumers, more recent data released since this estimate was made would indicate little change in this figure.

Most of the business-to-business remote sales tax impacts are associated with tax payments due from California businesses that legally are not required to register with the Board because they do not sell tangible personal property. Gross State Product (GSP) industry statistics show that over 50 percent of 1999 GSP was from service industries or finance, insurance, and real estate industries, most of which are not required to register with the Board.

Unlike personal income taxes, we are not aware of any states that allow businesses to report use tax liabilities on their corporate or other business income tax forms. About 90 percent of California businesses have fewer than 20 employees and could be considered to be relatively small. It would seem reasonable to expect use tax compliance rates for small businesses to be similar to those of individuals.

Since we have no specific information for businesses, we will also assume that having a line on corporate, subchapter S, and partnership income tax forms would result in one percent of unpaid use tax liabilities being reported. One percent of $783 million is approximately $8 million.

Revenue Summary

We would expect qualified use tax reported to be $13 million per year. The average state, local, and transit district revenue impacts associated with this bill are estimated to be:

State Impact (5.0%)	$ 8.2 million
Local Impact (2.25%)	$ 3.7 million
Transit Impact (0.67%)	$ 1.1 million
Total	$ 13.0 million

Qualifying Remarks

These revenue estimates assume compliance is largely voluntary. Costs of ensuring greater compliance could be high since there are a large number of potential taxpayers.

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