



STATE BOARD OF EQUALIZATION

STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	07/28/04	Bill No:	SB 1100
Tax:	Sales and Use	Author:	Senate Budget and Fiscal Review Committee
Board Position:		Related Bills:	AB 694 (Levine) AB 2107 (Levine) AB 2114 (Assembly Budget Committee) AB 2203 (Chu)

BILL SUMMARY

This Budget trailer bill would, among other things unrelated to the Board, do the following:

1. Provide that, for the period October 1, 2004 through July 1, 2006, it shall be rebuttably presumed that, except as specified, a vehicle, vessel, or aircraft purchased outside this state and brought into California within 12 months from the date of purchase is purchased for use in California and is subject to California use tax, except as specified (§ 6248).
2. Require the Board and the Franchise Tax Board (FTB) to administer a tax penalty amnesty program for a two-month period beginning February 1, 2005 and ending March 31, 2005, or any other two-month period ending June 30, 2005, as specified. With respect to the Board-administered taxes, the amnesty program would apply only to the sales and use tax program (§§ 6592, 7070, 7071, 7072, 7073, 7074, 7075, 7076, 7077 and 7078).

ANALYSIS

Vehicles, Vessels and Aircraft *Revenue and Taxation Code Section 6248*

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, or in the case of a vehicle or vessel, to the Department of Motor Vehicles.

Under current law and Board regulations, a vehicle, vessel, or aircraft purchased by a California resident is presumed to have been purchased for use in California and is subject to the California use tax. Also, a vehicle, vessel, or aircraft purchased by a nonresident is presumed to have been purchased for use in California if it enters this state within the first 90 days of ownership. These transactions are subject to the tax unless all of the following occur:

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- The purchaser takes title to and possession of the vehicle, vessel, or aircraft while it is out of state; and
- The purchaser makes the first functional use of it outside the state; and
- The purchaser uses it out of state for more than 90 days before the vehicle, vessel, or aircraft first enters California.

Under Regulation 1620, *Interstate and Foreign Commerce*, in determining the 90-day period of use outside California, the time is not counted when the vehicle, vessel, or aircraft was in shipment, or in storage for shipment, to California.

If the vehicle, vessel, or aircraft is purchased outside California and is first functionally used outside California but enters the state within the first 90 days of purchase (exclusive of time of shipment or storage for shipment to California), the vehicle, vessel, or aircraft is presumed to have been purchased for use in California unless it is used or stored outside the state more than 50 percent of the time during the six-month period immediately following the first entry into California.

Proposed Law

This bill would amend Section 6248 of the Sales and Use Tax Law to expand the existing presumption to a vehicle, vessel, or aircraft purchased outside this state. Specifically, the bill would provide that, for the period October 1, 2004 through July 1, 2006, it shall be rebuttably presumed that a vehicle, vessel, or aircraft bought outside this state and brought into this state during the first 12 months of the date of purchase, was acquired for storage, use, or other consumption in this state and is subject to use tax if any of the following occur:

- (a) The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the Vehicle Code.
- (b) In the case of a vehicle, the vehicle was subject to registration under Chapter 1 (commencing with Section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership.
- (c) In the case of a vessel or aircraft, the vessel or aircraft was subject to property tax in this state during the first 12 months of ownership.
- (d) The vehicle, vessel, or aircraft was used or stored in this state more than one-half of the time during the first 12 months of ownership.

The bill would further provide that this presumption may be controverted by documentary evidence, that the vehicle, vessel, or aircraft was purchased for use outside of this state during the first 12 months of ownership, that shall include, but not be limited to, evidence of registration of that vehicle, vessel, or aircraft with the proper authority outside of this state. In addition, the bill would clarify that the provisions do not apply to any vehicle, vessel, or aircraft used in interstate or foreign commerce pursuant to regulations prescribed by the Board.

And, finally, the bill would specify that an aircraft or vessel shall not be deemed to be purchased for use in this state if that aircraft or vessel is brought into this state for the purpose of repair, retrofit, or modification of the aircraft or vessel, provided that no more than 25 hours of airtime or sailing time are logged for that purpose, as specified.

The provisions would become effective on October 1, 2004 and would be repealed effective July 1, 2006. The bill would require the Legislative Analyst's Office to prepare a report by June 30, 2006 of the economic impact on the industry of the proposed changes to Section 6248.

Background

Similar provisions are also contained in Assembly Member Levine's AB 694, introduced in 2003 and currently on the Senate's inactive file, and AB 2107, in the Assembly Third Reading file. It was apparently prompted by a *Sacramento Bee* article concerning a perceived tax loophole with respect to current law. The article cited instances in which California purchasers of yachts from California yacht retailers were arranging delivery of the yachts outside the territorial waters of California, leaving them in Mexico for the 90-day period, and bringing them into California and escaping the California sales or use tax.

In General

The California sales tax generally does not apply to a transaction when a California retailer sells an item and ships it directly to the purchaser at an out-of-state location, for use outside California. The sale is regarded under the law as a sale in interstate commerce. In general, the sale is not taxable if the retailer:

- Ships the product directly to the purchaser, using his or her own delivery vehicle or another means of transport that he or she owns; or
- Ships the product by delivering it to a common carrier, contract carrier, customs broker, export packer, or forwarding agent.

In most cases, if a purchaser or his or her representative takes possession of an item in California — even temporarily — the sale does not qualify for the sales tax exemption. In addition, if the retailer delivers an item to a California resident at an out-of-state location, tax does apply, unless the purchaser states, in writing, that the item was purchased for use outside California. Nonetheless, if the retailer knows that the customer plans to use the item in California within 90 days of its purchase, the sale is subject to tax.

Comments

- 1. Purpose.** This budget trailer bill has been introduced in an attempt to address the revenue losses associated with the current 90-day rebuttable presumption provisions in law, thereby increasing the State's revenues.
- 2. Bill would not be problematic to administer.** This bill would actually minimize the staff time associated with investigating claimed exemptions, since the bill would essentially shift the burden of proof onto the purchaser to establish the exemption. Currently, the transaction is generally deemed exempt if it meets the 90-day test. Enactment of this measure would presume the transaction is subject to tax if it meets the criteria in the bill, and the responsibility would be placed on the purchaser to provide the necessary documentation to the Board to overcome that presumption of taxability.
- 3. Should the law be more stringent?** The Board's Consumer Use Tax Section routinely investigate transactions in which California purchasers take delivery of vehicles, vessels, or aircraft outside this state and claim an exemption for the California use tax under the current 90-day presumption provisions. According to

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that section, staff often finds that purchasers are residents of California who were informed of the use tax exemption by dealers or brokers who are using the tax avoidance opportunity as a sales incentive. Often the purchasers' travel itinerary is constructed around the exemption requirements established by law so as to avoid paying tax. Some would argue that this is not a tax loophole but simply good tax planning.

- 4. Related Legislation.** Similar provisions are contained in Assembly Bill 2114 (Assembly Budget Committee).

Amnesty

Revenue and Taxation Code Sections 6592, 7070, 7071, 7072, 7073, 7074, 7075, 7076, 7077 and 7078

Current Law

Under existing law, there are an array of penalties that are imposed under a variety of provisions of the Sales and Use Tax Law. These penalties are as follows:

1. For late payments generally, a penalty of 10 percent of the amount of all unpaid tax is added to any tax not paid in whole or in part within the time required by law.
2. For prepayments (for taxpayers with taxable sales in excess of \$17,000 per month, who are required to make two prepayments of the tax during each quarter) the following penalties apply:
 - Taxpayers who fail to make a prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due and who files a timely return and payment for that quarterly period is required to pay a penalty of 6 percent of the amount of prepayment, as specified, for each of the periods during that quarterly period for which a required prepayment was not made.
 - If the failure to make such a prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, the penalty is 10 percent instead of 6 percent.
 - Taxpayers who fail to make a timely prepayment, but who makes the prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due, is required to pay a penalty of 6 percent of the amount of the prepayment.
 - If any part of a deficiency in prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, a penalty of 10 percent of the deficiency is required to be paid.
3. A penalty of 25% applies to the amount of prepayment due but not paid by any distributor or broker of motor vehicle fuel who fails to make a timely remittance of the prepayment as required by law.
4. A penalty of 10 percent applies to the amount of prepayment due but not paid by any producer, importer, or jobber of fuel who fails to make a timely remittance of the prepayment as required by law. This penalty is 25 percent if the producer, importer, or jobber knowingly or intentionally fails to make a timely remittance.
5. A purchaser of a vehicle, vessel or aircraft who registers it outside this state for the purpose of evading the payment of sales or use taxes is liable for a penalty of 50 percent of any tax determined to be due on the sales price of the vehicle, vessel or aircraft.

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6. Any person who fails to file a timely return is required to pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
7. Any person remitting taxes by electronic funds transfer is required to, on or before the due date of the remittance, file a return for the preceding reporting period in the form and manner prescribed by the Board. Any person who fails to timely file the required return is required to pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
8. A penalty of 10 percent of the amount of the tax specified in a determination is added to deficiency determinations if any part of the deficiency for which the determination is imposed is due to negligence or intentional disregard of the law.
9. A penalty of 25 percent of the amount of the tax specified in a deficiency determination is added in cases of fraud or intent to evade the law or in the case of a determination for failure to file a return, if that failure is due to fraud or an intent to evade the law.
10. A penalty of 50 percent applies to the taxes imposed upon any person who, for the purpose of evading the payment of taxes, knowingly fails to obtain a valid permit prior to the date in which the first tax return is due. The 50 percent penalty applies to the taxes determined to be due for the period during which the person engaged in business in this state as a seller without a valid permit and may be added in addition to the 10 percent penalty for failure to file a return. However, the 50 percent penalty does not apply if the taxable sales or purchases over the period during which the person was engaged in business without a valid permit averaged \$1,000 or less per month.
11. A penalty of 10 percent of the amount of the tax specified in the determination shall be added to any determination not paid within the time required by law.
12. A penalty of 10 percent applies to the taxes imposed upon any person who knowingly issues a resale certificate for personal gain or to evade the payment of taxes while not actively engaged in business as a seller. The penalty is 10 percent of the amount of tax or \$500, whichever is greater, if the purchase is made for personal gain or to evade payment of taxes.
13. Every holder of a direct payment permit who gives an exemption certificate to a retailer for the purpose of paying that retailer's tax liability directly to the Board must make a proper allocation of that retailer's local sales and use tax liability and also its district transactions and use tax liability if applicable. Such allocation must be made to the cities, counties, city and county, redevelopment agencies, and district to which the taxes would have been allocated if they had been reported by that retailer. Allocations must be submitted to the Board in conjunction with the direct payment permit holder's tax return on which the taxes are reported. If the local and district taxes are misallocated due to negligence or intentional disregard of the law, a penalty of 10 percent of the amount misallocated is imposed.
14. Any person making sales to an operator of a catering truck who has been required by the Board to obtain evidence that the operator is the holder of a valid seller's permit and who fails to comply with that requirement is liable for a penalty of \$500 for each failure to comply.

15. Any retail florist who fails to obtain a seller's permit before engaging in or conducting business as a seller is liable, in addition to any other applicable penalty, for a penalty of \$500.

Under current law, any person who fails to pay tax to the state by the due date of that tax shall be assessed interest at the modified adjusted rate per month from the date the tax became due and payable to the state until the date of payment.

Current law provides different statute of limitations for various circumstances. Generally, the statute of limitations is 3-years from the date the return is due or the date the return is filed, whichever is later. In the event no return has been filed, the statute of limitations is 8-years from the date the return was due. If the taxpayer is guilty of fraud or intent to evade the tax, the statute of limitations is indefinite.

Under existing law, the Board administers a voluntary disclosure program, as authorized under Revenue and Taxation Code Sections 6487.05 and 6487.06. Under these sections, unregistered out-of-state retailers and California purchasers may voluntarily register with the Board and may be able to limit their liability for tax, penalties and interest due. Ordinarily, if the Board finds that an out-of-state retailer is liable for tax on its sales to California consumers, or a California purchaser owes use tax on its untaxed purchases, and that out-of-state retailer or California purchaser failed to file sales and use tax returns and report that tax, the law allows the Board to issue a deficiency determination for tax, interest, and penalties owed as long back as 8 years. Under the voluntary disclosure program, if an out-of-state retailer or California purchaser qualify, the billing period is limited to 3 years and relief of penalties may be provided.

Proposed Law

This bill would require the Board to administer a sales and use tax penalty amnesty program for the period beginning on February 1, 2005 and ending March 31, 2005, or any other period ending no later than June 30, 2005. The proposed amnesty program would apply to sales and use tax liabilities due and payable for tax reporting periods beginning before January 1, 2003.

The proposed tax amnesty program shall apply to any taxpayer who meets the following requirements:

1. Files a completed amnesty application with the Board.
2. For any taxpayer that has filed for bankruptcy protection under Title 11 of the United States Code, submits an order from a Federal Bankruptcy Court allowing the taxpayer to participate in the amnesty program.
3. Within 60 days after conclusion of the tax amnesty period, does all of the following:
 - Files completed tax returns for all tax reporting periods which have not been previously filed and files amended tax returns for all tax reporting periods in which an underreported tax liability exists.
 - Pays in full the taxes and interest due for all periods for which amnesty is requested, or applies for an installment payment agreement.
 - For taxpayers with outstanding tax liabilities due and payable for reporting periods beginning prior to January 1, 2003, pays in full the taxes and interest due for each period for which amnesty is requested, or applies for an installment payment agreement.

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Taxpayers may request to enter into an installment payment agreement in lieu of full payment provided the final payment under the terms of the agreement is due and is paid no later than June 30, 2006. Failure by the taxpayer to fully comply with the terms of the installment payment agreement would result in the waiver of penalties null and void and the total amount of tax, interest, and all penalties would be due and payable immediately.

As consideration for taxpayers participating in the amnesty program, the Board would waive all penalties normally imposed under the sales and use tax law for the reporting periods for which tax amnesty is allowed for the nonreporting or underreporting of tax liabilities, or the nonpayment of taxes previously determined or proposed to be determined. Additionally, no criminal action shall be brought against the taxpayer for the reporting periods for which amnesty is requested in cases of nonreporting or underreporting, unless the taxpayer is on notice of a criminal investigation or a court proceeding has already been initiated as of the first day of the amnesty period.

No refund or credit would be granted of any penalty paid prior to the time the taxpayer makes a request for amnesty.

After completion of the amnesty period, if the Board issues a deficiency determination upon a return filed under the amnesty program or upon any other nonreporting or underreporting of tax liability by a person who could have otherwise been eligible for amnesty, the taxpayer shall be assessed penalties at a rate that is double the rate of penalties normally applicable. Also, any deficiency determination issued under the above circumstance may be issued within 10 years from the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

In addition to the penalties provided above, any taxpayer who could have applied for amnesty shall be subject to a penalty of 50 percent of the accrued interest for the period beginning on the date the tax was due and ending on the last day of the amnesty period.

This bill would require that the Board adequately publicize the amnesty program so as to maximize awareness of the program.

Background

In 1984, AB 3230 (Hannigan et al.), Chapter 1490, Statutes of 1984, imposed the state's only tax amnesty program. The amnesty program waived penalties and criminal sanctions for taxpayers who had not properly complied with reporting and payment requirements under the Sales and Use Tax Law and the Personal Income Tax Law but who came forward during the amnesty period to file proper returns and make proper payments (including accumulated interest). The 1984 tax amnesty program was enacted as a "one-time-only" program that was linked to law changes which strengthened both this Board's and the Franchise Tax Board's enforcement tools and penalties immediately after the amnesty program's expiration. This 94-day amnesty program began December 10, 1984 and ended March 15, 1985.

Comments

- 1. Purpose.** This budget trailer bill has been introduced in response to the state's budget deficit with an amnesty program designed to generate a rapid cash flow for fiscal year 2005-06.
- 2. Taxpayer benefits.** The amnesty program affords a solution to taxpayers who have been concerned about the liabilities built up by mistakes in reporting over the years.

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The taxpayer would still be required to pay the tax and interest, but penalties would be waived under the amnesty provisions.

3. **Additional penalties.** In addition to the relief of penalties provided above, further incentive to convince taxpayers to participate in the amnesty program would be in the form of increased penalties for taxpayers who fail to participate in the amnesty program. These penalties include a penalty of 50 percent of the interest normally due until the end of the amnesty period and penalties imposed at double the normal rate. The state would also be given additional time to locate taxpayers who fail to participate in amnesty by extending the statute of limitations to 10 years for any period that could have been covered by amnesty.
4. **Related Legislation.** These same provisions are contained in Assembly Bill 2114 (Assembly Budget Committee).

COST ESTIMATE

Enactment of the vehicle, vessel and aircraft provisions in this bill may minimize the staff time devoted to claimed exemptions. However, this would not result in any measurable reduction in staffing.

The Board will incur significant costs as a result of the amnesty provisions in this bill. Costs will include notification of the public, processing of amnesty applications, return processing, computer programming, and answering inquiries from the public. Estimated costs are as follows:

	FY 2004-05	FY 2005-06	FY 2006-07
Personal Services	\$1,407,000	\$1,031,000	\$685,000
Operating Equipment and Expense	\$4,564,000	\$564,000	\$547,000
Total	\$5,971,000	\$1,595,000	\$1,232,000

It should be noted that the Department of Finance has approved the first year costs, with the exception of \$2.442 million in costs associated with a media campaign and general expenses (included in the Operating Equipment and Expense above). Funding for the media campaign would be given to the Franchise Tax Board which is expected to conduct a joint media campaign that would include the Board.

REVENUE ESTIMATE

Vehicles, Vessels and Aircraft

Revenue and Taxation Code Section 6248

Background, Methodology, and Assumptions

To determine the revenue impact of the current statute, the Board's Consumer Use Tax Section (CUTS) staff compiled statistics for the six months, ending on June 30, 2002, on vehicle, vessels, and aircraft files in which exemptions were granted or denied for both the 90-day and six-month principal use test supporting the exemption. In total, CUTS reviewed 1,408 files and found that 981 exemptions were granted resulting in a state and local revenue loss of \$27.3 million for the six months compiled. Under the proposed change in the law, all 981 of these exemptions would be taxable. The remaining 427 files were denied, representing \$5.6 million in use tax billed by the Board. Projected annually, this measure would increase by \$54.6 million (\$27.3 x 2) the

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collection of state and local sales and use tax revenue. It is expected that the provisions exempting the use of aircraft in this state for the sole purpose of repair, retrofit, or modification would not result in a revenue impact.

Revenue Summary

The vehicle, vessel and aircraft provisions in this bill would result in an annual increase in state and local sales and use tax revenue of \$54.6 million.

	<u>Revenue Effect</u>
State Gain (5.0%)	\$34.5 million
Local Gain (2.25%)	15.5 million
Special District Gain (.67%)	4.6 million
Total	<u>\$54.6 million</u>

Amnesty

*Revenue and Taxation Code Sections 6592, 7070, 7071, 7072,
7073, 7074, 7075, 7076, 7077 and 7078*

Background, Methodology, and Assumptions

The Board and the FTB administered a tax amnesty program during the 1984-1985 fiscal year. Under the terms of that amnesty program, penalties and criminal prosecution were waived, but not taxes and interest. The revenue, including both tax and interest, collected under that program was as follows:

Agency	Amount (in millions)	Percent of Total
FTB	\$154.0	78%
BOE	43.8	22%
Total	\$197.8	

Included in the above BOE total was revenue that was audit-related and already had been identified by the Board's staff although the liability had not yet been billed. For the 1984-85 amnesty program, the split between audit-related and non audit-related was as follows:

1984-85 Amnesty Program		
	Revenue	Percent of Total
Audit Related	\$28,471,078	65%
Non-Audit Related	\$15,330,581	35%
Total	\$43,801,659	

The provisions in this bill would include audit-related billed liabilities, self-assessments, as well as non-audit related taxpayer liabilities. Since the 1984-85 amnesty program, California's taxable sales have grown and the sales and use tax rate has increased. Assuming a taxpayer response similar to 1984-85, the proposed tax amnesty program audit related liabilities would accelerate the collection of the following revenue:

	Revenue (millions)
1984-85 Sales and Use Tax Revenue	\$12,875.3
2002-03 Sales and Use Tax Revenue	\$35,739.2
% Increase in Revenue	177.6%
Estimated 2003-04 Sales and Use Tax Revenue	\$37,133.0
% Increase from 1984-85	188.4%
1984-85 Amnesty Collections	\$28.5
Estimated 2004-05/06 Amnesty Collections	\$82.2

Please note this amount (\$82.2 million) would have been collected without the amnesty program. The amnesty program only accelerates the collection of current taxpayer liabilities.

The 1984-85 tax amnesty program included a number of enhanced enforcement tools that were to go into effect after the amnesty period. The use of these tools should result in a reduction in the number of taxpayers that would now be eligible for amnesty. We anticipate that taxpayer response will not be as substantial as what occurred in 1984-85. However, the provisions in this bill have a new interest penalty to encourage new taxpayers to come forward. We assume that the interest penalty should encourage taxpayer response by as much as 75% of the anticipated new revenue to be derived by the amnesty program from non-audit related activities as follows:

	Revenue (millions)
1984-85 Sales and Use Tax Revenue	\$12,875.3
2002-03 Sales and Use Tax Revenue	\$35,739.2
% Increase in Revenue	177.6%
Estimated 2003-04 Sales and Use Tax Revenue	\$37,133.0
% Increase from 1984-85	188.4%
1984-85 Amnesty Collections	\$15.3
Potential 2004-05/06 Amnesty Collections	\$44.1
75% of Potential Revenue Collections	\$33.1

This bill would impose a 50% interest penalty for taxpayers that choose not to participate during the two-month amnesty period. We estimate that penalty interest collections should amount to \$2 million. We anticipate this amount will be collected over a two-year period beginning with \$1.5 million collected in FY 2005-06, and \$0.5 million collected in FY 2006-07.

Revenue Summary

The estimated amount of tax revenue that would be derived from the proposed tax amnesty program would be as follows:

Amnesty Participation	2004/05	2005/06	2006/07	2007/08	Total
New Revenue	\$5.0	\$28.1			\$33.1
Revenue from Interest Penalty			\$1.5	\$0.5	\$2.0
Accelerated Revenue	\$12.3	\$69.9			\$82.2
Reduction in Revenue Stream			-\$60.0	-\$22.2	-\$82.2
Total	\$17.3	\$98.0	-\$58.5	-\$21.7	\$35.1

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