



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Third District, Rolling Hills Estates

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Interim Executive Director

September 30, 2011

Dear Interested Party:

Staff has reviewed comments received in response to our August 29, 2011 interested parties meeting regarding Regulation 1685.5, *Calculation of Estimated Use Tax – Use Tax Table*. After considering the comments and information provided to date, staff is recommending amendments to Regulation 1685.5.

Enclosed is the *Second Discussion Paper* on this subject. This document provides the background, a discussion of the issue and explains staff's recommendation in more detail. Also enclosed for your review is a copy of the proposed amendment to Regulation 1685.5 (Exhibit 1).

A second interested parties meeting is scheduled **in Room 122 at 10:00 a.m. on October 11, 2011** to discuss the proposed amendments to Regulation 1685.5. If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the October 11, 2011 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on October 11, 2011, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Mr. Robert Wilke at 916-445-2137 or by e-mail at Robert.Wilke@boe.ca.gov prior to October 5, 2011. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing.

Any comments you may wish to submit subsequent to the October 11, 2011 meeting must be received by **October 28, 2011**. They should be submitted in writing to the above address or by e-mail to Mr. Wilke.

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We look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Hellmuth, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,



Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB: rsw

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(Via E-mail)

Mr. Robert Thomas, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Yvette Stowers, Board Member's Office, First District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Kristine Cazadd
Mr. Randy Ferris
Mr. Jeffrey L. McGuire
Mr. Jeff Vest
Mr. David Levine
Mr. Bradley Heller
Mr. Robert Tucker
Mr. Todd Gilman
Ms. Laureen Simpson
Mr. Robert Ingenito Jr.
Mr. Bill Benson
Mr. Joe Fitz
Mr. Stephen Rudd
Mr. Kevin Hanks
Mr. Geoffrey E. Lyle

Ms. Leila Hellmuth
Mr. Robert Wilke
Mr. Bradley Miller

SECOND DISCUSSION PAPER

Regulation 1685.5, Calculation of Estimated Use Tax – Use Tax Table

I. Issue

Whether it is necessary to amend Regulation 1685.5, *Calculation of Estimated Use Tax – Use Tax Table*, to update the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income (AGI) and make such amounts available to the Franchise Tax Board (FTB) in the form of a use tax table for calendar-year 2012 and subsequent years.

II. Staff Recommendation

After the review of interested party submissions and the discussion at the first interested party meeting on August 29, 2011, staff agrees with a number of suggested changes and recommends amending Regulation 1685.5 to:

- Clarify the persons who are eligible to use the use tax table to report their use tax obligations and for what type of purchases;
- Require an adjustment to the U.S. Spending at Electronic Shopping and Mail Order Houses, published by the U.S. Census Bureau, to estimate taxable purchases of tangible personal property;
- Increase the number of adjusted gross income ranges to a total of fifteen (15); and
- Modify the intervals of the established AGI ranges.

The proposed revised regulation is attached as Exhibit 1.

III. Other Alternatives Considered

No alternate regulatory language was proposed.

IV. Background

Section 6452.1 of the Revenue and Taxation Code (RTC), as amended by Senate Bill No. 86 (Stats. 2011, ch. 14) approved by the Governor on March 24, 2011, requires the Board to annually calculate the estimated amount of use tax due according to a person's AGI and, by July 30 of each calendar year, make available to the Franchise Tax Board (FTB) such amounts in the form of a use tax table for inclusion in the instructions to the FTB's income tax returns. Section 6452.1 also gives eligible consumers the option to satisfy their use tax obligations with regard to their nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1,000) by reporting their estimated amount of use tax as calculated by the Board on their California income tax returns. Furthermore, section 6452.1 includes a "safe harbor" provision that precludes the Board from assessing the difference between a consumer's reported estimated use tax liability based on the Board's use tax table and the consumer's actual use tax liability, for eligible nonbusiness purchases, provided the consumer uses the table correctly.

The Board adopted Regulation 1685.5 on July 26, 2011. The regulation was approved by the Office of Administrative Law (OAL) on August 16, 2011, and became effective on

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September 15, 2011. The Board was unable to hold interested parties meetings to discuss Regulation 1685.5 prior to beginning the formal rulemaking process given the statutory requirement that the Board provide the 2011 use tax table to the FTB by July 30, 2011, and other practical deadlines. However, the Board directed staff to meet with interested parties to discuss whether Regulation 1685.5 needs to be amended before the Board is required to estimate consumers' use tax liabilities and prepare a use tax table for 2012. Staff met with interested parties on August 29, 2011, to discuss whether to amend Regulations 1685.5. The Business Taxes Committee is scheduled to discuss this issue at the December 15, 2011, committee meeting.

Discussion of the Use Tax Table in the Current Regulation

The use tax law has been in existence since 1935. California's use tax generally applies to the storage, use, or other consumption of tangible personal property in California that was purchased from an out-of-state retailer. (RTC § 6201.) California's use tax is intended to eliminate the incentive for California consumers to purchase tangible personal property from out-of-state retailers in order to avoid paying the sales tax that would apply if the property was sold in California.

California's use tax is imposed on consumers. (RTC § 6202.) However, out-of-state retailers that are engaged in business in California must register with the Board and collect any applicable use tax from their California customers. (Regulation 1684.) Furthermore, consumers may satisfy their use tax liabilities by paying applicable use taxes to retailers that are registered with the Board and retaining receipts showing that they paid the taxes. Otherwise, consumers are required to report and pay their own use tax liabilities. (Regulation 1685.)

California consumers that do not maintain complete records of their purchases of tangible personal property throughout the year may have difficulty determining how much they spent on purchases of tangible personal property from out-of-state retailers, and whether they paid use tax to the out-of-state retailers when they made their purchases. In addition, some consumers may have difficulty determining the cumulative rate of state, local, and district use tax applicable to their purchases of tangible personal property. The optional use tax table prescribed by Regulation 1685.5 is intended to make it more convenient for eligible consumers to comply with their use tax reporting obligations by eliminating the need for each consumer to maintain records regarding eligible nonbusiness purchases, the need for each consumer to determine his or her own cumulative state, local, and district use tax rate, and the need for each consumer to calculate his or her actual use tax liability. Eligible consumers include those persons who are not required to hold a seller's permit or register with the Board of Equalization under the Sales and Use Tax Law.

With respect to the allocation of total use tax paid, the amounts received from the use tax line on the FTB returns will continue to be allocated according to the taxpayer's address as received by the FTB. Local taxes will be allocated to the countywide pools and applicable district taxes will be allocated based on the countywide pools, with consideration given as to whether the

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taxpayer's address is within a city that imposes a district tax. The balance is then allocated to the statewide components of the use tax rate.

Methodology in the Current Regulation

Regulation 1685.5 prescribes a reasonable methodology for estimating consumers' use tax liabilities based upon their AGI ranges using a "use tax liability factor" determined by:

1. Multiplying the percentage of total personal income spent on electronic and mail order house purchases for the preceding calendar year, as determined from data provided by the United States Bureau of Economic Analysis and the United States Census Bureau, by 0.37, which represents the estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers; and
2. Multiplying the product by the weighted average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent.

An example of the calculation is provided below.

The Board determined that this methodology provides a reasonably accurate estimate of California consumers' use tax liabilities based upon the assumptions that California consumers spend an average percentage of their incomes on electronic and mail order purchases and that they also make an average percentage of their total purchases of tangible personal property for use in California from unregistered out-of-state retailers. The Board recognizes that a particular consumer's actual use tax liability may be higher or lower than the consumer's estimated use tax liability as determined using the methodology in the regulation; however, that would be the case with any reasonable estimate. In addition, consumers always have the option to report their actual use tax liabilities.

The format of the use tax table prescribed by Regulation 1685.5 allows the majority of consumers to find their AGI within an established AGI range and read across to the right column to find their estimated use tax liabilities. However, consumers with AGIs over \$199,999 are required to multiply their actual AGIs by the use tax liability factor specified for their AGI range to determine their estimated use tax liabilities. Therefore, the use tax table eliminates the need for consumers preparing California personal income tax returns reporting AGIs that are \$199,999 or less, regardless of filing status (i.e., single, married, filing jointly, etc.), to perform any mathematical calculations to estimate, report, and pay their eligible use tax liabilities,¹ and greatly simplifies the calculations that consumers with AGIs over \$199,999 are required to make to calculate, report, and pay their actual use tax liabilities. Furthermore, the format of the use tax table prescribed by Regulation 1685.5 completely eliminates the need for all eligible consumers

¹ Data provided by the FTB indicates that 96 percent of California personal income tax returns filed for taxable year 2008, the most recent year for which data is available, reported AGIs of \$200,000 or less. Therefore, staff believes that the current format of the Board's use tax tables eliminates the need for approximately 96 percent of California consumers who purchased tangible personal property for use in California from unregistered out-of-state retailer to calculate their own use tax liabilities.

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to refer to any external sources for additional information, such as the use tax rate, in order to estimate, report, and pay their eligible use tax liabilities.

The AGI ranges used in the use tax table prescribed by Regulation 1685.5 are based on AGI ranges provided by the FTB and there are similar percentages of California taxpayers in each AGI range. Staff understands that nine other states have use tax tables. Of those nine states, three states have more AGI ranges (Maine-11, Oklahoma-31, and North Carolina-31) than California, three states have less AGI ranges (Kansas-6, Massachusetts-6, and Vermont-7) than California, and three have the same number of AGI ranges (Michigan, New York and New Jersey) as California (8).

Example Calculation of Use Tax Liability Factor in Current Regulation

The following example illustrates how the use tax liability factor prescribed by Regulation 1685.5 is calculated:

Example of Calculation to Determine Use Tax Liability Factor

I. Determine the percentage of total personal income that is spent on electronic and mail order purchases:

a) U.S. Personal Income (Billions of Dollars) ^{1/}	\$xx,xxx
b) U.S. Spending at Electronic Shopping and Mail Order Houses (Billions of Dollars) ^{2/}	\$ xxx
c) Percent of Income Spent on Electronic and Mail Order Purchases (b/a)	x.x%

II. Multiply the result from Step I(c) by .37 ^{3/}:
(c*.37)

.xxxxx

III. Multiply the product from Step II by the weighted average state, local, district sales and use tax rate (rounded to the nearest thousandth of a percent):

Use Tax Liability Factor (Step II*weighted average tax rate) .xxxx

1/ U.S. Bureau of Economic Analysis

2/ U.S. Census Bureau

3/ Estimated percentage of California consumers total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers.

V. Discussion

The Board understands that there is more than one method that can be used to estimate consumers' use tax liabilities based upon their AGIs and has directed staff to discuss ways that the methodology prescribed by Regulation 1685.5 could be improved.

In their written comments on September 14, 2011 (Exhibit 2) the California Taxpayers Association (CalTax) expressed support for the use tax table concept, but indicates that it

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believes that to be successful, the table must be presented fairly and must be easy for taxpayers to use. For ease of discussion, CalTax's comments with respect to revisions to Regulation 1685.5 are summarized below and then responded to in the order presented.

- The U.S. Spending at Electronic Shopping and Mail Order Houses data, published by the U.S. Census Bureau, does not account for purchases of tangible personal property for resale, purchases of exempt tangible personal property, and purchases of tangible items with a sales price of \$1,000 or more;
- The Board should consider allowing persons who do not file income tax returns the option to report their use tax obligations based on the use tax table.
- The format of the use tax table prescribed by Regulation 1685.5 should have more than eight AGI ranges;
- The methodology for estimating consumers' use tax liabilities prescribed by Regulation 1685.5 should be revised so that it estimates that consumers in the lower AGI ranges pay more use tax as a percentage of their AGI than consumers in the higher AGI ranges because sales and use taxes are generally regressive; and
- The format of the use tax table should account for the various district tax rates in effect throughout the state.

U.S. Spending at Electronic Shopping and Mail Order Houses

As explained above, one component of the calculation of the estimated use tax is the total amount of U.S. Spending at Electronic Shopping and Mail Order Houses, obtained from the U.S. Census Bureau. The U.S. Census Bureau surveys businesses in detail every five years in its *Economic Census*. CalTax expressed concern that the data used did not exclude property purchased for resale or exempt property. Staff examined the data obtained from the U.S. Census Bureau in greater detail and determined that the data provided consists of retail sales, so an adjustment for property purchased for resale is not warranted. Staff also reviewed *Retail Trade: Industry Series: Preliminary Product Lines Statistics by Kind of Business for the United States: 2007* and determined that the following categories of items, included in the U.S. Census Bureau's total U.S. Spending at Electronic Shopping and Mail Order Houses, and separately itemized in the additional statistics, were either fully or substantially nontaxable:

1. Groceries and other foods for human consumption off premises;
2. All other food products;
3. Prescriptions;
4. Video Content Downloads;
5. Audio Content Downloads;
6. Prepackaged computer software, including software downloads; and
7. All nonmerchandise receipts.

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Staff also determined that the U.S. Census Bureau's calculation of U.S. Spending at Electronic Shopping and Mail Order Houses does not include all taxable purchases of tangible personal property from unregistered out-of-state retailers for use in California, and estimated that it failed to account for approximately \$10 billion of total taxable and nontaxable purchases from electronics and appliance stores, building materials and garden equipment and supplies stores, food and beverage stores, health and personal care stores, clothing and clothing accessories stores, sporting goods, hobby, book, and music stores, general merchandise stores, and other miscellaneous stores. This would include items purchased from websites operated by retailers who do not fall within the electronic shopping category of business and items hand carried into the state.

CalTax was also concerned that the U.S. Spending at Electronic Shopping and Mail Order Houses data was not adjusted for purchases of items with a sales price of \$1,000 or more. Staff is not aware of any data sources of individual purchase transactions and their amounts from Internet or mail order companies that could be used to isolate the dollar value of sales of such large purchases. However, staff analyzed *The 2011 Internet Retailer Top 500 Guide* (Vertical Web Media LLC, Chicago, Illinois, online version), which has data on average ticket (transaction) purchases for 2010. Staff ranked this data and found that eight of the 500 companies had average ticket purchases of \$1,000 or more and were located outside of California. (The retail industries were jewelry, furniture, fitness equipment, and coin dealers.) These eight companies accounted for less than one-half of one percent of total sales made by the *Internet Retailer Top 500* companies and there was no data to determine what portion of their tickets contained purchases of single items with a sales price of \$1,000 or more, rather than purchases of multiple items, each with a sales price of less than \$1,000, but with a total ticket price of \$1,000 or more.

Based on the above, staff recommends that the Board amend Regulation 1685.5 to require that \$10 billion be added to the U.S. Spending at Electronic Shopping and Mail Order Houses data, obtained from the U.S. Census Bureau, and that the revised total be reduced so as to eliminate all seven of the fully or substantially nontaxable categories of sales data. However, staff does not believe that the regulation needs to be amended to account for sales of individual items with a sales price of \$1,000 or more and staff still does not know how to account for such sales. (See proposed amendments to Regulation 1685.5, subd. (c)(4))

Allow nonfilers of income tax returns to use the use tax table

CalTax inquired about allowing persons who did not file income tax returns the option to report their use tax obligations based on the use tax table. RTC section 6452.1 provides that a taxpayer may elect to report qualified use tax on an acceptable tax return. An acceptable tax return is defined to mean a timely filed 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 (commencing with Section 18501) of Part 10.2, or Article 3 (commencing with Section 23771) of Chapter 4 of Part 11. Since qualified use tax is limited to being reported on an income tax return, staff believes that the BOE is precluded at this time from allowing persons who do not file income tax returns to use the use tax table to report use tax.

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AGI Ranges

CalTax expressed concern that the current AGI range intervals in the Board's use tax tables are too broad and that the tables should include many more AGI ranges. As explained above, staff understands that three of the nine states with use tax tables have use tax tables that employ more AGI ranges than California. Staff understands that the number of AGI ranges and the intervals of such ranges can affect a particular taxpayer's estimated use tax liability. Staff understands that establishing additional AGI ranges with narrower intervals will increase the probability that a taxpayer's estimated use tax liability determined using the Board's use tax tables will be closer to that taxpayer's estimated use tax liability determined by multiplying the taxpayer's actual AGI by the Board's use tax liability factor. In addition, increased AGI ranges will result in tables that have estimated use tax liabilities that increase/decrease by lesser amounts between AGI ranges. Therefore, staff recommends amending Regulation 1685.5 so as to nearly double (increase from 8 to 15) the number of AGI ranges in the Board's use tax tables. Specifically, staff recommends using AGI range intervals of \$10,000 (rather than \$20,000) up to an AGI of \$99,999. In addition, staff recommends establishing additional AGI ranges for AGI ranges between \$100,000 and \$199,000 with intervals of \$25,000 (rather than \$50,000). The highest AGI range will continue to be AGI of more than \$199,999 and taxpayers in this range will continue to be required to calculate their estimated use tax liabilities by multiplying their actual AGIs by the use tax liability factor. Although taxpayers in the highest range are required to perform an additional step to calculate their use tax liabilities, staff estimates the number of taxpayers within the highest range is approximately 4 percent and staff believes this format provides a simple table for a majority of taxpayers. (See proposed amendments to Regulation 1685.5, subd. (c)(1).)

Regressivity

CalTax states that the methodology for estimating consumers' use tax liabilities prescribed by Regulation 1685.5 should be revised to account for the regressive nature of the sales and use tax. However, CalTax did not provide specific details in their submission.

Staff understands that, of the nine other states with use tax tables, two states (New York and New Jersey) have use tax tables that estimate that consumers in the lower AGI ranges pay more use tax as a percentage of their AGI than consumers in the higher AGI ranges. Staff also understands that Chart 4 in the May 2011 Board of Equalization *Economic Perspective*, a tabulation of data from the 2010 edition of the *Internet Retailer Top 500 Guide* indicates that households with incomes greater than \$100,000 have an Internet purchase to income ratio that is 60 percent of the average for all of the lower income households. This data is for all Top 500 Internet retailer companies and the magnitude of this number is similar to that found in the research publication: "Determinants of Recent Online Purchasing and the Percentage of Income Spent Online," Brendan Hannah and Kristina M. Lybecker, Department of Economics and Business, Colorado College, *International Business Research*, Volume 3, Number 4, October 2010. However, Board staff is not currently aware of any reliable data that staff could use to determine how each AGI range in the Board's use tax tables should be adjusted for such regressivity.

Staff does not know if it is reasonable to assume that consumers' spending patterns change so drastically after their AGIs exceed \$100,000 that their Internet purchase to income ratios

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immediately decrease by 40 percent or that their spending patterns change at some even rate as their AGI's increase. Staff believes that it is more likely that consumers' Internet purchase to income ratios begin to gradually decrease sometime just before their AGIs exceed \$100,000 and that consumers' Internet purchase to income ratios continue to decrease at an uneven rate until eventually, very high AGI consumers actually have Internet purchase to income ratios that are below 60 percent of the ratios for consumers with AGIs below \$100,000. And, that this uneven and gradual decline accounts for the 40 percent reduction in Internet purchase to income ratios for consumers with AGIs from \$100,000 to the highest reported AGI in California versus consumers with AGIs between \$0 and \$99,999. However, again, staff does not have sufficient data to make a firm recommendation at this time.

As a result, staff would be willing to recommend some amendment to Regulation 1685.5 so that the Board's use tax tables account for regressivity if staff can find sufficient data or arrive at a generally accepted methodology to account for regressivity. Board staff welcomes further input on this issue.

Local Taxes

CalTax also believes that the use tax table must account for the various district tax rates and suggests this may be addressed by providing a discount to taxpayers who live in an area with no district tax or by calculating the estimated amount of use tax due based on the combined statewide tax rate of 7 percent, which includes the Bradley-Burns amount. (Staff believes that there was a typographical error in CalTax's written comments and that CalTax may have intended to specify a rate of 7.25%). CalTax further states that it prefers the former over the latter because using an "add on" or different tables to account for district tax would complicate the reporting of use tax for most taxpayers. Staff agrees that keeping the table simple will result in more widespread use of the table and staff believes that providing a discount may be just as complicated and/or impracticable as using add-ons or multiple tables to account for district taxes. Many taxpayers may be confused by the term "district tax" and may not know if they reside in an area imposing a district tax that qualifies for the discount or not. Since the whole premise of a use tax look up table is based upon estimates, staff believes the current methodology of using a weighted average for the sales and use tax rate is still the most reasonable under the circumstances.

Other Comments

CalTax requested clarification as to what information is included in the U.S. Personal Income data published by the U.S. Bureau of Economic Analysis. Staff looked at the U.S. Personal Income data further and determined that it includes the current income received by persons from all sources; that is, from their contributions to production (from their labor or from owning a home or business), from transfers from government and businesses, and from the ownership of financial assets (such as interest and dividends). Additional comments received from CalTax are beyond the scope of amendments to the regulation, but are relevant to the implementation and administration of the look up table. Such comments pertain to the inclusion of information about the table in the "What's New" section of the personal income tax booklets distributed by FTB,

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making sure the table is prominently placed in the personal income tax booklets, and making sure that FTB properly communicates with software developers and computerized tax processors regarding the new table. Board staff has been working closely with FTB staff since the passage of SB 86 to ensure that the table with accompanying instruction is properly included in the personal income tax booklets, the “What’s New” section also includes information about the new table, and the information about the new table is shared with software developers and computerized tax processors.

VI. Conclusion

Staff proposes amendments to Regulation 1685.5, as illustrated in Exhibit 1, to improve the precision of the Board’s estimated amount of use tax due according to a person’s AGI. The proposed amendments also prescribes the format of the use tax table for 2012 and subsequent years; however, the use tax liability factors are subject to change based on the most current data available as prescribed by the regulation. Interested parties are welcome to submit comments or suggestions on the issues discussed in this paper, and are invited to participate in the interested parties’ meeting scheduled for October 11, 2011.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of: September 30, 2011

Regulation 1685.5. Calculation of Estimated Use Tax – Use Tax Table

Reference: Section 6452.1, Revenue and Taxation Code.

(a) IN GENERAL.

(1) ESTIMATED USE TAX AND USE TAX TABLE. The Board of Equalization (BOE) is required to annually calculate the estimated amount of use tax due according to a person's adjusted gross income (AGI) and make such amounts available to the Franchise Tax Board (FTB), by July 30 of each year, in the form of a use tax table for inclusion in the instructions to the FTB's returns.

(2) WHO IS ELIGIBLE TO USE BOE USE TAX TABLES. Consumers, other than consumers required to hold a seller's permit or to register with the BOE under the Sales and Use Tax Law and report their use tax liabilities directly to the BOE, may elect to use the use tax tables included in the instructions to their FTB returns to report their estimated use tax liabilities for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand (\$1,000) on their FTB returns. However, eligible consumers may still calculate their actual use tax liabilities using the worksheets in the instructions to their FTB returns and report their actual use tax liabilities on their FTB returns. Consumers are not required to use the use tax tables included in the instructions to their FTB returns.

(3) SAFE HARBOR. If eligible consumers use the use tax tables included in the instructions to their FTB returns to estimate their use tax liabilities for qualified nonbusiness purchases and correctly report their estimated use tax liabilities for their qualified nonbusiness purchases in accordance with their AGI ranges, then the BOE may not assess the difference, if any, between the estimated use tax liabilities reported in accordance with the use tax tables and the consumers' actual use tax liabilities for qualified nonbusiness purchases.

(b) DEFINITIONS AND DATA SOURCES.

(1) AGI RANGES. The use tax table shall be separated into fifteen (15)~~eight (8)~~ AGI ranges as follows:

- ~~(A) AGI less than \$20,000;~~
- ~~(B) AGI of \$20,000 to \$39,999;~~
- ~~(C) AGI of \$40,000 to \$59,999;~~
- ~~(D) AGI of \$60,000 to \$79,999;~~
- ~~(E) AGI of \$80,000 to \$99,999;~~
- ~~(F) AGI of \$100,000 to \$149,999;~~
- ~~(G) AGI of \$150,000 to \$199,999;~~
- ~~(H) AGI more than \$199,999.~~
- (A) AGI less than \$10,000;

(B) AGI of \$10,000 to \$19,999;

(C) AGI of \$20,000 to \$29,999;

(D) AGI of \$30,000 to \$39,999;

(E) AGI of \$40,000 to \$49,999;

(F) AGI of \$50,000 to \$59,999;

(G) AGI of \$60,000 to \$69,999;

(H) AGI of \$70,000 to \$79,999;

(I) AGI of \$80,000 to \$89,999;

(J) AGI of \$90,000 to \$99,999;

(K) AGI of \$100,000 to \$124,999;

(L) AGI of \$125,000 to \$149,999;

(M) AGI of \$150,000 to \$174,999;

(N) AGI of \$175,000 to \$199,999;

(O) AGI more than \$200,000

(2) **USE TAX LIABILITY FACTOR OR USE TAX TABLE PERCENTAGE.** For the 2011 calendar year the use tax liability factor or use tax table percentage shall be 0.070 percent (.0007). On May 1, 2012, and each May 1 thereafter, the BOE shall calculate the use tax liability factor or use tax table percentage for the current calendar year by multiplying the percentage of income spent on ~~taxable electronic and mail order~~ purchases for the preceding calendar year by 0.37, multiplying the product by the average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent.

(3) **TOTAL PERSONAL INCOME.** Total personal income shall be determined by reference to the most current personal income data published by the United States Bureau of Economic Analysis.

(4) **TOTAL SPENDING AT ELECTRONIC SHOPPING AND MAIL ORDER HOUSES.** Total spending at electronic shopping and mail order houses shall be determined by reference to the most current electronic shopping and mail order house spending data published by the United States Census Bureau.

(5) TOTAL SPENDING ON TAXABLE PURCHASES. Total spending on taxable purchases shall be determined by:

(A) Determining the percentage of total spending at electronic shopping and mail order houses that are not included in the following categories of items:

(i) Groceries and other foods for human consumption off premises;

(ii) All other food products;

(iii) Prescriptions;

(iv) Video Content Downloads;

(v) Audio Content Downloads;

(vi) Prepackaged computer software, including software downloads; and

(vii) All nonmerchandise receipts.

(B) Adding ten billion dollars (\$10,000,000,000) to the total spending at electronic shopping and mail order houses to account for spending that is not included in the spending data published by the United States Census Bureau; and

(C) Multiplying the sum by the percentage of total spending at electronic shopping and mail order houses that are not included in the categories of items listed above so that the result does not include spending on nontaxable purchases, and then rounding the result to the nearest tenth of a percent.

~~(6)(5) PERCENTAGE OF INCOME SPENT ON TAXABLE ELECTRONIC AND MAIL ORDER PURCHASES.~~ The percentage of income spent on taxable electronic and mail order purchases during a calendar year shall be calculated by dividing the total spending on taxable purchases at electronic shopping and mail order houses for that year by the total personal income for that year, multiplying the result by 100, and rounding the result to the nearest tenth of a percent.

~~(7)(6) AVERAGE STATE, LOCAL, AND DISTRICT SALES AND USE TAX RATE.~~ The average state, local, and district sales and use tax rate for a calendar year shall be the total of:

(A) The rates of the statewide sales and use taxes imposed under section 35 of article XIII of the California Constitution and the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) in effect on January 1 of that year;

(B) The statewide rate of local tax imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code, § 7200 et seq.) in effect on January 1 of that year; and

(C) The weighted average rate of the district taxes imposed under the Transactions and Use Tax Law (Rev. & Tax Code, § 7251 et seq.) in effect in the various jurisdictions throughout the state on January 1 of that year after taking into account the proportion of the total statewide taxable transactions (by dollar) reported for each jurisdiction during the fourth quarter of the calendar year that is two years prior to the calendar year for which the calculation is made. For example, the total reported taxable transactions (by dollar) for the fourth quarter of 2010 shall be used to determine the weighted average rate of the district tax rates in effect on January 1, 2012, to calculate the weighted average rate of district taxes for calendar year 2012.

(c) CALCULATION OF THE ESTIMATED USE TAX LIABILITY.

(1) The estimated use tax liability for the AGI range described in subdivision (b)(1)(A) shall be determined by multiplying ~~\$5,000~~\$10,000 by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

Second Discussion Paper
Staff proposed revisions to Regulation 1685.5

Exhibit 1

(2) The estimated use tax liability for the AGI ranges described in subdivision (b)(1)(B) through ~~(N)(G)~~ shall be determined by multiplying the midpoint of each AGI range by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

(3) The estimated use tax liability for the AGI range described in subdivision (b)(1)(~~OH~~) shall be determined by multiplying each range members actual AGI by the use tax liability factor or use tax table percentage and then rounding the result to the nearest whole dollar.

(d) USE TAX TABLE FORMAT.

(1) The use tax table for calendar year 2011 shall provide as follows:

Adjusted Gross Income (AGI) Range	Use Tax Liability
Less Than \$20,000	\$7
\$20,000 to \$39,999	\$21
\$40,000 to \$59,999	\$35
\$60,000 to \$79,999	\$49
\$80,000 to \$99,999	\$63
\$100,000 to \$149,999	\$88
\$150,000 to \$199,999	\$123
More than \$199,999 -Multiply AGI by 0.070% (.0007)	

(2) The use tax tables for calendar year 2012 and subsequent years shall utilize the same format as follows:~~the use tax table for calendar year 2011.~~

<u>Adjusted Gross Income</u> <u>(AGI) Range</u>	<u>Use Tax Liability</u>
<u>Less Than \$10,000</u>	<u>\$</u>
<u>\$10,000 to \$19,999</u>	<u>\$</u>
<u>\$20,000 to \$29,999</u>	<u>\$</u>
<u>\$30,000 to \$39,999</u>	<u>\$</u>
<u>\$40,000 to \$49,999</u>	<u>\$</u>
<u>\$50,000 to \$59,999</u>	<u>\$</u>
<u>\$60,000 to \$69,999</u>	<u>\$</u>
<u>\$70,000 to \$79,999</u>	<u>\$</u>
<u>\$80,000 to \$89,999</u>	<u>\$</u>
<u>\$90,000 to \$99,999</u>	<u>\$</u>
<u>\$100,000 to \$124,999</u>	<u>\$</u>
<u>\$125,000 to \$149,000</u>	<u>\$</u>
<u>\$150,000 to \$174,999</u>	<u>\$</u>
<u>\$175,000 to \$199,999</u>	<u>\$</u>
<u>More than \$199,999 -Multiply AGI by % (.000)</u>	



Attn: Susanne Buehler
Board of Equalization
450 N Street
Sacramento, CA 95814

Dear Susanne,

Thank you for your time on August 29 to discuss potential changes to Regs. Sec. 1685.5. Here is a recap of ideas expressed by Dave Doerr, Rob Gutierrez and me, concerning the current use tax table. Note that CalTax is supportive of the use tax table concept, but, in order for it to be successful, the table must be presented fairly and must be easy for taxpayers to use.

- Methodology:
 - The data that the board staff used did not exclude property purchased for resale or exempt property. You should make an allowance for these nontaxable items.
 - The data that the board staff used did not provide for an allowance for larger purchases (on items valued at more than \$1,000). You should make an allowance for these items.
 - We would appreciate additional information on what is included in “personal income” (i.e., Schedule C, etc.) for purposes of your calculations.
 - We would appreciate more information on how the 40 percent growth rate used over three years during a recessionary period is calculated – statistical confirmation would be helpful.
 - Consider allowing nonfilers to report use tax liabilities through the use tax table. The table was constructed with data for taxpayers who file tax returns and excluded nonfilers. This seems to be a fundamental flaw.

- Regressivity:
 - Use tax studies show that other states often adjust their use tax table for regressivity. The structure of California’s table needs to match the use tax structure.
 - Base AGI ranges on percentages (see MN, NJ and NY) and use many more ranges.

Susanne Buehler
September 14, 2011
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- Local Taxes:
 - The use tax table must account for district tax rates (this is one reason that CalTax has been, and remains, a strong proponent of a uniform state and local sales and use tax rate). This issue may be addressed by providing a discount to taxpayers who live in an area where there is no district tax (other states do this).
 - Using different tables to address district taxes or doing an “add on” would only serve to complicate the table. Another option is to collect local use tax at the 7 percent rate to include the Bradley-Burns amount.

- Other Comments & Concerns:
 - CalTax is satisfied that the table has been adjusted appropriately for rate changes.
 - There is a step problem with the table. For example, if AGI goes up by \$1 for a taxpayer with AGI of \$99,999, use tax goes up by \$25. You may be able to solve this problem by using $7 + 7$ percent over a range, for example.
 - Make sure that you provide the FTB with language to include in the “What’s New” section of their PIT booklets.
 - Make sure the table is prominently placed in the PIT booklets.
 - Make sure that the FTB properly communicates with software developers and computerized tax processor (CTPs) regarding the table. Good communication is the key to this program’s success. I am on the FTB’s mailing list for CTPs and have not read one sentence about the use tax table.

Again, thank you for your efforts and for including CalTax in your discussions.

Sincerely,



Vice President, State Tax Policy