



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0043
TELEPHONE (916) 445-1441
FAX (916) 445-2388
www.boe.ca.gov

June 13, 2003

CAROLE MIGDEN
First District, San Francisco

BILL LEONARD
Second District, Ontario

CLAUDE PARRISH
Third District, Long Beach

JOHN CHIANG
Fourth District, Los Angeles

STEVE WESTLY
State Controller, Sacramento

TIMOTHY W. BOYER
Interim Executive Director

Dear Interested Party :

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the June 25, 2003, Business Taxes Committee meeting. This meeting concerns the *Proposal to Address, on Certain Franchise Tax Board Returns, the Subject of Use Tax Obligations Related to Purchases from Out-of-State Retailers.*

Action 1 and Action 2 on the Agenda consist of items on which we believe industry and staff are in full agreement.

If you wish to have any consent items (Action 1 and/or 2) discussed fully at the Committee meeting, you must contact a Board Member prior to Wednesday, June 18 to request removal of the item from the Consent Agenda. In addition, please notify Ms. Charlotte Paliani, Program Planning Manager, after you contact a Board Member's Office. Ms. Paliani may be reached at (916) 324-1825.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **Wednesday, June 25, 2003**, in Room 121 at the address shown above.

Sincerely,

Ramon J. Hirsig
Deputy Director
Sales and Use Tax Department

RJH: ca

Enclosures

cc: (all with enclosures)
Honorable Carole Migden, Chairwoman
Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable John Chiang, Member, Fourth District
Honorable Steve Westly, State Controller
Ms. Carole Ruwart, Board Member's Office, First District (MIC 71)
Ms. Sabina Crocette, Board Member's Office, First District
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Mr. Matthew Zylowski, Board Member's Office, Third District
Ms. Margaret Pennington, Board Member's Office, Second District (MIC 78)
Mr. Lee Williams, Board Member's Office, Second District (via e-mail)
Mr. Tim Treichel, Board Member's Office, Second District (via e-mail)
Mr. John Thiella, Board Member's Office, Fourth District (MIC 72)
Ms. Marcy Jo Mandel, State Controller's Office
Mr. Matt Paulin, Department of Finance
Ms. Mary Ann McMullin, Department of Finance
Mr. Timothy Boyer (MIC 73)
Acting Chief Counsel (MIC 83)
Ms. Janice Thurston (MIC 82)
Mr. Warren Astleford (MIC 82)
Mr. Robert Tucker (MIC 82)
Ms. Sharon Jarvis (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Mr. Rey Obligacion (via e-mail)
Ms. Jennifer Willis (MIC 70)
Mr. Dan Tokutomi (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Charlotte Paliani (MIC 92)
Mr. Joseph Young (via e-mail)
Mr. Jerry Cornelius (via e-mail)
Mr. Jeffrey L. McGuire (via e-mail)
Mr. Vic Anderson (MIC 40 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Laureen Simpson (MIC 50)
Mr. Charles E. Arana Jr. (MIC 50)
Ms. Laura Jonoubei (MIC 50)

FRANCHISE TAX BOARD STAFF

Mr. Bruce Langston, Legal Branch (via e-mail)
Ms. Lisa Crowe, Chief, Filing Division (via e-mail)
Ms. Pat Pavone, Filing Services Bureau (via e-mail)
Ms. Kimmie Lee, Tax Forms Development and Distribution (via e-mail)
Ms. Cathy Lewis, Tax Forms Development and Distribution (via e-mail)
Ms. Leslie Tanaka, Tax Forms Development and Distribution (via e-mail)
Mr. Raul Guzman, Tax Forms Development and Distribution (via e-mail)
Mr. Dan Hoeffner, Tax Forms Development and Distribution (via e-mail)
Mr. George Ramsey, Statistical Research Section (via e-mail)
Ms. Jennifer Sallee, Processing Services Bureau (via e-mail)
Ms. Holly Browning, Policy and Branch Support Bureau (via e-mail)
Ms. Jana Howard, Legislative Services Bureau (via e-mail)

IP-3.doc rev. 2-6-03

AGENDA —June 25, 2003 Business Taxes Committee Meeting
Proposal to Address, on Certain Franchise Tax Board Returns, the Subject of Use Tax Obligations Related to Purchases from Out-of-State Retailers

<p>Action 1 — Agreed Upon Item.</p> <p>Add a line to Franchise Tax Board returns regarding use tax obligations related to purchases from out-of-state retailers.</p>	<p>Adopt staff’s recommendation that a line, consisting of a question and check boxes, be included on certain Franchise Tax Board returns regarding use tax obligations related to purchases from out-of-state retailers.</p> <p>The following line is proposed: “Did you buy items from out of state or online without paying sales/use tax? See page __ <input type="checkbox"/>No<input type="checkbox"/>Yes”</p>
<p>Action 2 — Agreed Upon Item.</p> <p>Pursue statutory change to address the issue of due date differences and timely filing of returns.</p>	<p>Adopt staff’s recommendation to pursue statutory change to address the issue of due date differences and timely filing of returns.</p>

Issue Paper Number 03-006



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposal to Address, on Certain Franchise Tax Board Returns, the Subject of Use Tax Obligations Related to Purchases from Out-of-State Retailers

I. Issue

Should a line be added to Franchise Tax Board (FTB) returns regarding use tax obligations related to purchases from out-of-state retailers?

II. Staff Recommendation

Staff recommends that a line, consisting of a question and check boxes, be included on certain FTB returns (as agreed upon by the FTB and Board of Equalization (BOE) and listed in Exhibit 2) regarding use tax obligations related to purchases from out-of-state retailers.

Further, staff recommends that the BOE pursue statutory change to address the issue of due date differences and timely filing and payment of use tax returns.

III. Other Alternative(s) Considered

Do not add a line to the FTB returns, regarding use tax obligations related to purchases from out-of-state retailers.

Issue Paper Number: **03-006**

IV. Background

The sales tax was created in 1933. The complementary use tax, established in 1935, was intended to protect California businesses from tax-free, out-of-state competition. Revenue and Taxation Code (RTC) section 6201 imposes an excise tax (use tax) on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. The use tax is imposed at the same rate as the sales tax.

The California use tax applies most commonly to transactions when the sale is not made in California but the property is purchased for use in California, for example, purchases shipped from an out-of-state point to a California consumer. Under RTC section 6202, persons are liable for use tax when they store, use, or otherwise consume in this state tangible personal property purchased from a retailer for storage, use or other consumption in this state. A person's liability is not extinguished until the tax has been paid to this state, to a retailer engaged in business in this state, or to a retailer who is authorized by the BOE to collect the tax. If an out-of-state seller is not registered to collect the use tax, or is registered but fails to collect the use tax, a consumer is required to report and pay his or her liability directly to the BOE.

Based on estimates by the BOE, California loses over \$450 million annually in use tax revenue from mail order and electronic commerce from purchases made by individuals for their own use. In addition, use tax revenue loss resulting from electronic commerce sales from out-of-state businesses to California businesses is estimated to be \$783 million.

At the request of the BOE, the FTB has included instructions for paying California use tax in the FTB income tax instruction booklets for many years. The instructions are currently located on page 60 of the California 540 and 540A 2002 Personal Income Tax Booklet.

In March 2000, the BOE developed Publication 79-B, *California Individual Use Tax*, which contains Form BOE-401-DS, *Individual Income Tax Return*. The Individual Use Tax Return form was developed to make the process of reporting use tax more convenient for the taxpayer by providing a BOE-approved format to report the use tax liability on a purchase made by a California resident from an out-of-state retailer not holding a California seller's permit or Certificate of Registration - Use Tax. Before the availability of this form, a taxpayer generally would send a brief letter of explanation, in lieu of a return, along with payment of the use tax owed to the BOE. Publication 79-B can be accessed through the FTB's website and the BOE's website at www.boe.ca.gov/pdf/pub79b.pdf. Publication 79-B is also available in BOE district offices.

In an effort to make reporting use tax more convenient for the public and to further educate California residents on their responsibility to report use tax, the BOE made arrangements with FTB to insert a modified version of Publication 79-B into the center of the FTB's 2002 540/540A and 540 2EZ Personal Income Tax Booklets that were mailed to taxpayers. There were 2.3 million 540/540A mailings and 2.61 million 540 2EZ mailings. An additional 570,000 540 2EZ booklets (containing the use tax return insert) were made available in public areas such as libraries and post offices.

However, these mailings did not reach the majority of income tax filers in California. There are currently 14 million individual income tax filers in California, but the number of persons using the individual income tax instruction booklets is declining due to an increase in e-filing and tax software

Issue Paper Number: **03-006**

programs that are available to the public. As a means of ensuring that most FTB filers are aware of their potential use tax liability, it is proposed that a line, consisting of a question and check boxes, be added to certain FTB returns to remind taxpayers that they owe use tax on their purchases from out-of-state retailers or websites. The following text is proposed:

“Did you buy items from out of state or online without paying sales/use tax? See page __ NoYes”

The text must be limited in length because there is little additional room available on the FTB returns. In addition, instructions will direct the taxpayer to obtain a use tax return from the FTB or BOE website, at any BOE district office, or by calling the BOE’s Information Center; to complete the individual use tax return; and to mail the use tax return and payment to the BOE. Under this proposal, the use tax return would not be inserted into the FTB tax instruction booklets. Staff expects that the largest revenue impact from this proposal will come from filers such as businesses not required to hold a seller’s permit, who file using tax software programs and/or employ the services of an accountant. Since these filers do not receive income tax instruction booklets, they would not receive a use tax return included with these booklets. In addition, as a result of the insertion of the modified Publication 79B into the 2002 income tax instruction booklets, a large number of income/use tax returns were mailed to the incorrect agency, thereby increasing costs for both agencies.

This approach will not only increase taxpayer awareness of his or her responsibility to report use tax, but will also reach most taxpayers that file an income tax return. As a result, the BOE will reach a much larger population of California taxpayers because relatively few taxpayers file sales and use tax returns in comparison to the number who file income tax returns.

Many other states have added a line for the reporting and paying of use tax to their income tax returns. In general, the practice has been very successful, with some states showing more than a 10-fold increase in use tax reporting. However, it should be noted other states do not have dual tax agencies as is the case in California. As a result, they do not have the same complexities when implementing this type of program.

Issue Paper Number: **03-006**

The following is a sample of the results experienced by some states that have added a use tax line to their income tax return:

STATE (year use tax line added to return)	YEAR	Number of Use Tax Returns	Amount (\$)	Percentage of Income Tax filer's who paid use tax
Michigan (1999)	1998	3000	240,500	
	1999	64650	2,900,000	1.5
	2000	80150	3,089,000	1.8
	2001	72650	3,113,400	1.6
Louisiana (2000)	1998		Under 25,000	
	1999		Under 25,000	
	2000	10165	585,200	Under 1
	2001	9950	565,378	Under 1
Vermont (1974)	1998	5017	238,344	1.8
	1999	4593	219,955	1.6
	2000	4703	199,465	1.7
	2001	4256	183,875	1.5
Wisconsin (1988)	1998	25044	1,328,636	.94
	1999	23601	1,347,424	.88
	2000	25050	1,393,659	.91
	2001	24706	1,335,969	.91
Utah (1980's)	1998	3467	162,227	.41
	1999	3988	186,968	.44
	2000	4002	205,551	.43
	2001	5497	245,225	.58

Interested Parties Meeting, April 24, 2003

Staff discussed the addition of the line to the FTB returns with FTB staff and interested parties at an interested parties meeting held on April 24, 2003. In addition, participants discussed the submission, dated March 28, 2003, from Ms. Gina Rodriguez of Spidell Publishing Inc. (Spidell). Spidell prefers the addition of a use tax line to the FTB returns and collection of the use tax by the FTB. Discussion also addressed concerns over the insertion of the modified Form 79B in the income tax booklets, undertaken in 2002.

Issue Paper Number: **03-006**

Most of the concerns and issues mentioned in Spidell's submission were related to the part of Spidell's preference for the FTB to collect the use tax. Spidell noted that tax practitioners were not consulted when the BOE developed its pilot program to include the modified version of Publication 79B in the 2002 FTB income tax instruction booklets. Both staff's current proposal and Spidell's preference would affect tax software vendors and tax practitioners involved with the use tax filing requirements. If the use tax line is put on the FTB's returns, software vendors will need to update their software and may want to include the use tax return. Ideally, the software will include the use tax form and when the "yes" box is marked, it will automatically invoke completing the use tax form. Also, tax practitioners will be obliged to advise their clients regarding the use tax reporting requirements and to complete the additional use tax form if necessary.

In response, staff notes that over 100 tax software vendors were included in the discussion paper mailing and this issue paper mailing. None of these vendors attended the April 24, 2003, interested parties meeting. Staff did receive a call from Creative Solutions, a tax software vendor, who stated that it planned to include Publication 79B with the tax software it was developing for the 2003 year.

During discussions regarding the BOE's proposal, a suggestion was made that the proposed line be included on every FTB income tax return. Representatives from the FTB explained that currently it is difficult to get all the needed information on their tax returns. Adding a line would require expanding some forms to one or more additional pages. This would greatly increase the expenses associated with the returns. It was also noted that other states do not include the line on every form (for example, a non-resident income tax return). It was agreed that the California Forms 565 (Partnerships) and 568 (Limited Liability Companies) would be added to the list of those returns incorporating the use tax line. Exhibit 2 shows those returns that are included in the proposal.

Other concerns with the proposal included the following:

Since, in general, a use tax return is due on a quarterly basis, taxpayers who file a use tax return annually with their income tax return may not be filing their use tax returns on a timely basis under this proposal. For example, a person filing a use tax return and payment in January will be timely filing for purchases made in the fourth quarter of the prior year, but the filing will *not* be timely for tangible personal property used, stored, or consumed in this state *prior* to the fourth quarter of that year. Moreover, if the use tax return and payment is filed after January 31, this return and payment will not be timely for any tangible personal property used, stored, or consumed in this state during the prior calendar year. Accordingly, it is recommended that the issue of timely filing and payment of a return be addressed through statutory change.

A concern was raised that the FTB might "invalidate" an income tax return if the filer fails to either file a use tax return or respond to the use tax line on the return. Representatives from the FTB informed BOE staff that failure to file a use tax return or respond to the use tax question would not invalidate the income tax return.

Spidell pointed out that taxpayers are concerned that the FTB audit staff might develop profiles based on taxpayers' use tax payment history. Participants agreed this is a valid concern, since FTB audit staff could use reported use tax amounts as an indicator for income tax audits.

Issue Paper Number: **03-006**

Senate Bill 1009

Senate Bill (SB) 1009, introduced by Senator Alpert, would shift responsibility for collection of “qualified use tax,” as defined by the legislation, to the Franchise Tax Board. This bill is supported by Spidell. Currently, the bill would be effective for the 2004 tax year. If SB 1009 passes, it would supersede staff’s recommendation.

SB 1009 passed the Senate Appropriations Committee on May 29, 2003. The bill is currently being heard on the Senate floor and was last amended on June 3, 2003. The BOE is working with the author of the bill to address the issues and concerns raised by Spidell, FTB, and BOE staff.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that a line, consisting of a question and check boxes, be included on certain FTB returns (as agreed upon by the FTB and BOE and listed in Exhibit 2) regarding use tax obligations related to purchases from out-of-state retailers purchased for storage, use or other consumption in California. The following line is proposed:

“Did you buy items from out of state or online without paying sales/use tax? See page __ No Yes.”

Further, staff recommends that the BOE pursue statutory change to address the issue of due date differences and timely filing and payment of use tax returns.

B. Pros of the Staff Recommendation

- Can be implemented quickly with minimal costs (see Fiscal Impact) and in time for the 2003 income tax returns.
- Inexpensive way to publicize the requirement to pay use tax. Most taxpayers are not aware of their use tax obligations. Adding the line to certain FTB income tax returns will increase awareness, and it is expected that a greater percentage of taxpayers will comply with the law.
- Statutory change is not required to place the question and check boxes on the FTB returns.
- Does not have two different types of taxes (franchise/income tax and use tax) being reported on one return.
- Expected to increase state and local tax revenue.

C. Cons of the Staff Recommendation

- Receipt of returns by the incorrect agency may occur.
- Resolution of Spidell’s concerns regarding the issue of the due date of the use tax returns will be delayed pending the introduction and passage of new legislation.

D. Statutory or Regulatory Change

Staff recommends pursuing statutory change to address the issue of timely filing of returns.

Issue Paper Number: **03-006**

E. Administrative Impact

- The estimated increase of approximately 58,000 use tax returns annually will increase BOE's workload (the approximate number of use tax returns was computed by multiplying the number of income tax returns - 14.5 million - by the estimated participation rate - .004 - as explained in Exhibit 1).
- Will increase the number of calls to the BOE's Information Center and district offices. It is assumed that FTB staff will handle the simplest questions; however, they will forward the majority of the calls to the BOE's Information Center. BOE staff has estimated that 60,000 calls will be received by the Information Center.
- Requires additional printing and an increase in stock supply of Form 79B.

F. Fiscal Impact

1. Cost Impact

The preliminary cost estimate for the BOE to process the additional workload is approximately \$606,000 in the first year and \$428,000 in subsequent years. In addition, the preliminary cost to reimburse the FTB to include the line on the form, to key the entry, and to send a report to the BOE showing those taxpayers with "yes" responses is approximately \$144,000 in the first year and \$19,000 in subsequent years. However, the cost is reduced to \$22,000 in the first year if the FTB does not key the taxpayer responses and does not send the BOE a report.

In summary, the estimated implementation cost in the first year is \$750,000 (\$600,000 General Fund and \$150,000 Reimbursement), and ongoing costs are estimated at \$447,000 (\$358,000 General Fund and \$89,000 Reimbursement).

2. Revenue Impact

Approximately \$6.5 million increase in use tax revenues. See Revenue Estimate, Exhibit 1.

G. Taxpayer/Customer Impact

- Will require consumers to keep track of purchases made that are subject to California use tax.
- May be negatively perceived and criticized as another tax increase.

H. Critical Time Frames

In order to include this line on the 2003 FTB returns, language and instructions must be provided to the FTB by June 30, 2003.

VI. Alternative 1

A. Description of the Alternative

Do not add a line to the FTB returns, regarding use tax obligations related to purchases from out-of-state retailers for storage, use or other consumption in California.

B. Pros of the Alternative

Does not require regulatory or statutory change.

Issue Paper Number: **03-006**

C. Cons of the Alternative

- Expected increases in state and local tax revenue will not occur.
- Awareness of the requirement to pay use tax will not be increased.

D. Statutory or Regulatory Change

Does not require statutory or regulatory change.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate, Exhibit 1.

G. Taxpayer/Customer Impact

There will not be an increased awareness of the use tax reporting requirements.

H. Critical Time Frames

None.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 06/12/03

REVENUE ESTIMATE

(REV. 6/00)

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



PROPOSAL TO ADDRESS, ON CERTAIN FRANCHISE TAX BOARD RETURNS, THE SUBJECT OF USE TAX OBLIGATIONS RELATED TO PURCHASES FROM OUT-OF-STATE RETAILERS

Proposal

Staff Recommendation:

Staff recommends that a line, consisting of a question and check boxes, be included on certain FTB returns regarding use tax obligations related to purchases from out-of-state retailers.

Further, staff recommends that the BOE pursue statutory change to address the issue of due date differences and timely filing and payment of use tax returns.

Alternative 1

Do not add a line to the FTB returns, regarding use tax obligations related to purchases from out-of-state retailers.

Background, Methodology, and Assumptions

Staff Recommendation:

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

Revenue Estimate

liabilities. No data was 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 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 are not legally required to register with BOE 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 Estimate Adjustment for This Specific Proposal. Summing revenues from both consumers and businesses results in a total of \$13 million (\$5 million from consumers and \$8 million from businesses). However, a downward adjustment to this figure needs to be made to account for the difference in the way taxpayer's report and remit their liabilities. Most of the states responding to the FTA survey added a line to their personal income tax forms for individuals to report use tax due. In contrast, the issue paper proposal directs the FTB taxpayer to complete and file an additional return with the BOE, which is a much less convenient way for taxpayers to report and remit use tax obligations. This additional step is likely to reduce revenues received. BOE staff estimates that it would not be unreasonable to expect a 50 percent decline in revenues to result from this difference in reporting methods. This is based on a 50% estimate of Franchise Tax Board filers using software or accountants. It is projected that the majority of the use tax returns will be filed by these taxpayers.

Revenue Estimate

Alternative 1:

Alternative 1 has no revenue effect.

Revenue Summary

Under staff's recommended proposal, we would expect sales and use taxes reported to be \$6.5 million per year. The average state, local, and transit district revenue impacts are shown below.

State Impact (5.0%)	\$ 4.1 million
Local Impact (2.25%)	\$ 1.8 million
<u>Transit Impact (0.67%)</u>	<u>\$ 0.6 million</u>
Total	\$ 6.5 million

The alternative proposal has no revenue effect.

Qualifying Remarks

This revenue estimate assumes compliance is largely voluntary. With additional BOE staff follow-up, at additional cost, revenue from staff's proposal could increase.

Preparation

Mr. Joe Fitz, Research and Statistics Section, Legislative Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative Division, and Ms. Charlotte Paliani, Program Planning Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Fitz at (916) 323-3802.

Current as of June 12, 2003

Franchise Tax Board Use Tax Line Inclusion/Exclusion By Return Type

Category	Return Type	2004 Projected Volume ¹
Personal Income Tax Forms that <u>will include</u> the Use Tax Line	540	8,567,540
	540A	3,253,446
	5402EZ	2,003,226
Personal Income Tax forms that <u>will not include</u> the Use Tax Line	540NR (Non-Residents)	634,806
	541 (Trusts)	296,160
	540X (Amended)	124,965
Business Entity Tax forms that <u>will include</u> the Use Tax Line	100	245,775
	100S	205,012
	565 (Partnerships)	211,061
	568 (Lmt. Liability Cos.)	101,672
Business Entity Tax forms that <u>will not include</u> the Use Tax Line	100W (Water's Edge)	4,687
	109 (Exempts)	2,935
	100X (Amended)	² 15,264

G:\BTC\BTC TOPICS - 2003\03-0201-FTB UseTax\Papers\FTB Use Tax IP Exhibit 2.doc

¹ These volumes are based on the 2001 Tax Year returns that were received in 2002, except as noted in Footnote 2. Growth factors of 0.8% per year for PIT and 4.2% per year for BE were applied to the 2002 volumes to project 2004 volumes.

² This figure is based on the amended returns received in 2001 plus growth of 4.2% per year.