

[Assembly Bill 405](#) (Brough)

Date: 02/19/2015

Program: Sales and Use Tax, Special Taxes and Fees

Sponsor: Author

Revenue and Taxation Code 6591.5

Effective: January 1, 2016

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Summary: Makes the interest rate paid on overpayments the same as the rate paid on late payments with respect to Board of Equalization (BOE)-administered tax and fee programs.

Purpose: To eliminate the interest rate disparity between overpayments and late payments. In 1991, the Legislature reduced the rate paid on overpayments dramatically because of an unfavorable court decision which required the state to refund significant amounts with interest. These court-ordered refunds have long since been paid, and the significant disparity should be eliminated.

Fiscal Impact Summary: \$3.5 million revenue loss for fiscal year (FY) 2015-16, increasing to \$30.1 million for FY 18-19.

Existing Law: Existing law¹ requires persons who are late paying a tax, fee, or surcharge (collectively “tax”) to pay a 10% penalty, plus interest on the unpaid tax from the tax due date to the last day of the month of payment. The BOE calculates interest on a late payment based on the Internal Revenue Service (IRS) rate,² plus 3%. That rate is 6% currently.

Existing law also requires the BOE to pay interest on tax overpayments unless the overpayment was intentional or due to carelessness. The law requires a different interest calculation on overpayments than for late payments. For overpayments, the law specifies that interest is computed based on the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent.³

Since July 1, 2009, the bond equivalent rate of 13-week treasury bills has been so low that, when rounded to the nearest full percent, the rate is zero. Consequently, since July 1, 2009, the BOE has not paid interest on tax overpayments.

Before July 1, 1991, the same interest rates applied on overpayments and late payments. However, AB 2181⁴ and SB 179⁵ changed the tax overpayment interest rate. Instead of the IRS rate plus 3%, the law requires interest paid on overpayments to be the bond equivalent rate of 13-week treasury bills auctioned – a rate generally 6- 8% lower. Therefore, current law sets the interest rate on overpayments significantly lower than the rate charged on late payments.

Proposed Law: This bill deletes the provisions that specify the tax overpayment interest rate shall be equal to the bond equivalent rate of 13-week treasury bills auctioned. The bill specifies that the modified adjusted rate per annum (for late payments and overpayments) means the rate determined in accordance with IRS’s underpayment rate plus 3%.

The bill also defines “modified adjusted rate per month, or fraction thereof” to mean the modified adjusted rate per annum divided by 12.

The various BOE-administered special tax and fee laws currently reference these provisions for the applicable interest rates. Accordingly, these proposed changes apply also to those programs’

¹ Division 2 of the Revenue and Taxation Code.

² Internal Revenue Code Section 6621.

³ If that rate is a multiple of ½ of 1 %, the rate increases to the next highest full percent.

⁴ Chapter 85, Stats. 1991.

⁵ Chapter 88, Stats. 1991.

overpayment interest rates.

Background: The chart on page 4 of this analysis provides an overview of the interest rates since 1987. Due to an unfavorable decision in *Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300, the Department of Finance (DOF) proposed a revised method for computing overpayment interest. The court decision involved sales and use tax issues related to U. S. Government contractors in California and resulted in BOE tax refunds associated with specified U.S. Government transactions. DOF suggested this change due to the potentially significant revenue loss resulting from interest on those tax refunds.

Since 1992, 17 different bills have been introduced to provide equal interest rates on overpayments and late payments (see chart on page 5 of this analysis). The BOE voted unanimously to sponsor 13 of those 17 measures, the most recent in 2013 (AB 1049, Harkey, et al.). However, due to the fiscal effect, either the policy or fiscal committee held all but one. The Legislature approved a 1992 measure one year after the interest rate disparity was enacted, but Governor Pete Wilson vetoed the legislation. In his veto message, Governor Wilson stated:

“Legislation enacted last year (Chapter 85, Statutes of 1991) established a separate, lower rate for state and local sales tax refund liability. Chapter 85 was enacted to minimize the impact of accruing interest as a result of the Aerospace decision. This bill would reverse that legislation, thereby reinstating the higher rate on refund liability.

“Imposing a lower rate for refunds minimizes the impact on the state in the event of large taxpayer refund liability. Imposing a higher rate on amounts owed by taxpayers serves as an incentive for taxpayers to remit those amounts in a timely manner as well as to comply with the law. I do not wish to change these incentives.”

Commentary:

- 1. Effect of the bill.** This bill increases the overpayment credit interest rate to equal the late payment interest rate.
- 2. Interest is not a penalty.** The law imposes penalties for late payments. Interest, however, represents a charge for the use of funds.
- 3. This bill aligns BOE’s overpayment interest rate with the IRS and Franchise Tax Board (FTB).** The IRS and the FTB do not have disparate interest rates on non-corporate overpayments and underpayments. The IRS has only a 1% disparity for corporate overpayments (the disparity is higher if the corporate underpayment is over \$100,000 or the corporate overpayment exceeds \$10,000). The FTB has a 3% disparity for corporate overpayments.
- 4. The law prohibits interest on intentional overpayments.** In the tax, fee, and surcharge programs the BOE administers, current law specifies that if the BOE determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest. This serves as a disincentive for intentional overpayments made to gain interest.

Administrative Costs: The administrative costs are absorbable.

Revenue Impact:

Background, Methodology, and Assumptions

During calendar year 2014, the BOE made sales and use tax refunds of \$353 million; and an estimated \$70 million in special taxes refunds. Since July 1, 2009, the credit interest rate (the amount of interest paid on overpayments) has been 0%; consequently no interest has been paid on these refunds since that time. Since July 1, 2012, the debit interest rate (the amount of interest charged on underpaid or late tax

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payments) has been 6%. If the credit and debit interest rates had been the same over a four calendar year period, the BOE would have paid out credit interest of approximately \$30.1 million.

Revenue Summary

Since an interest rate change affects interest accrued only after the bill’s effective date, the full effect of the increased overpayment interest rate will take a number of years to be fully realized. A 6% overpayment rate increase will have a total first year effect for all BOE tax and fee programs of \$3.5 million. The full effect of \$30.1 million will occur in the fourth year.

Year	State			Local	Transit	Total
	Special Taxes	Sales & Use Tax	Total			
2015-16	\$419,366	1,626,908	\$2,046,274	1,122,795	337,297	\$3,506,366
2016-17	\$1,557,645	6,042,800	\$7,600,445	4,170,383	1,252,817	\$13,023,645
2017-18	\$3,534,657	13,712,507	\$17,247,164	9,463,561	2,842,931	\$29,553,657
2018-19	\$3,600,000	13,966,004	\$17,566,004	9,638,510	2,895,487	\$30,100,000

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Board of Equalization
Interest Rates 01/01/87 through Current

From	To	Assessments	Refunds	
01/01/87	09/30/87	11%	11%	
10/01/87	12/31/87	13	13	
01/01/88	03/31/88	14	14	
04/01/88	09/30/88	13	13	
10/01/88	03/31/89	14	14	
04/01/89	09/30/89	15	15	
10/01/89	06/30/91	14	14	
07/01/91	12/31/91	14	6	
01/01/92	06/30/92	13	6	
07/01/92	12/31/92	12	4	
01/01/93	06/30/93	11	3	
07/01/93	12/31/94	10	3	
01/01/95	06/30/95	11	4	
07/01/95	06/30/96	12	6	
07/01/96	12/31/98	12	5	
01/01/99	06/30/99	11	5	
07/01/99	12/31/99	10	4	
01/01/00	12/31/00	11	5	
01/01/01	12/31/01	12	6	
01/01/02	06/30/02	10	4	
07/01/02	06/30/03	9	2	
07/01/03	06/30/04	8	1	
07/01/04	06/30/05	7	1	
07/01/05	12/31/05	8	2	
01/01/06	06/30/06	9	3	
07/01/06	12/31/06	10	4	
01/01/07	06/30/08	11	5	
07/01/08	12/31/08	10	3	
01/01/09	06/30/09	8	2	
07/01/09	12/31/09	8	0	
01/01/10	06/30/11	7	0	
07/01/11	12/31/11	6	0	
01/01/12	06/30/12	7	0	
07/01/12	06/30/15	6	0	

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The following table provides the legislative history of measures that addressed the interest rate disparity. The BOE sponsored the bills in **bold**.

Year	Legislation	Proposal	Final Status
2014	AB 2429 Patterson	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2013	AB 1049 Harkey, et al.	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2012	AB 2048 Donnelly	Equalize interest rates	Held in Assembly Appropriations Committee
2011	SB 421 Correa	Equalize interest rates	Senate Governance and Finance Committee adopted amendments to reduce the interest rate on underpayments by 3%; bill was subsequently held in Senate Appropriations Committee
2008	AB 1926 Shirley Horton	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2005	AB 1589 Villines	Equalize interest rates	Held in Assembly Appropriations Committee
2001	SB 825 Poochigian	Equalize interest rates	Held in Senate Revenue and Taxation Committee
2000	Stats. 2000, Ch. 607 (AB 2612)	As introduced, equalize rates	Enacted to add an uncodified section that declares the intent of the Legislature that the interest rates be the same
2000	AB 1208 AR&T Comm.	Equalize interest rates	Provisions amended out in Senate Appropriations Committee
1999	AB 464 Maldonado	Equalize interest rates	Held in Assembly Appropriations Committee
1997	AB 222 Takasugi	Equalize interest rates	Amended in the Senate to increase the credit interest rate by 1%, but held in the Senate Appropriations Committee
1995	AB 397 Hannigan	Equalize interest rates	Comprehensive measure to make many significant changes to the tax laws and vetoed by Governor Wilson (interest rate provision not specifically addressed in veto message)
1995	AB 1190 Morrissey	Equalize interest rates	Provisions amended out in Assembly Revenue and Taxation Committee
1995	AB 1189 Takasugi	Equalize interest rates	Held in the Senate Appropriations Committee
1994	AB 3487 Andal	Equalize interest rates	Held in the Assembly Revenue and Taxation Committee
1993	AB 2083 Takasugi	Equalize interest rates	Not heard in committee
1992	AB 2972 Mays	Equalize interest rates	Vetoed by Governor Wilson

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