



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

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Date Amended:	<b>03/22/11</b>	Bill No:	<a href="#"><u>Senate Bill 421</u></a>
Tax Program:	<b>Sales and Use Special Taxes and Fees</b>	Author:	<b>Correa</b>
Sponsor:	<b>BOE</b>	Code Sections:	<b>RTC 6591.5</b>
Related Bills:		Effective Date:	<b>01/01/12</b>

**BILL SUMMARY**

This Board of Equalization (BOE)-sponsored bill would revise the interest calculation provisions in the BOE administered tax and fee programs so that the rate of interest allowed on refunds of tax and fee overpayments is the same as that calculated on late payments.

**ANALYSIS**

**CURRENT LAW**

Under existing law, persons who are late in payment of their tax, fee or surcharge (tax) obligations are required to pay a penalty of 10 percent of the tax, plus interest on those unpaid taxes from the date the tax was due to the date upon which they are paid. Interest on a late payment of tax is calculated using the Internal Revenue Service (IRS) rate pursuant to provisions of the Internal Revenue Code, plus three percent. That rate is currently seven percent.

Existing law also provides for interest to be granted to persons who have overpaid their tax or fees (when it is determined that the overpayment was not intentional or a result of carelessness). Interest on overpayments is calculated differently than it is for late payments. For overpayments, the law specifies that interest be calculated based on the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent (or if that rate is a multiple of 1/2 of one percent, the rate is increased to the next highest full percent). Recently, the bond equivalent rate of 13-week treasury bills has been so low that, when rounded to the nearest full percent, the rate is actually 0 percent for purposes of the credit interest rate on overpayments. Consequently, no interest has been granted on overpayments of tax made for any period starting July 1, 2009 through today.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the BOE to taxpayers on overpayments and late payments. However, AB 2181 and SB 179 (Chs. 85 and 88, Stats. 1991, respectively) significantly changed the computation of *credit* interest on overpayments of tax. Instead of using the IRS rate plus three percent for overpayments, the law required that interest on overpayments be based on the bond equivalent rate of 13-week treasury bills auctioned – a rate that is generally six to eight percent lower. Therefore, under current law, there is significant difference in the rate of interest paid on overpayments and the rate of interest assessed on late payments.

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### PROPOSED LAW

This bill would amend Revenue and Taxation Code Section 6591.5 of the Sales and Use Tax Law to specify that the rate established for interest payable by the state upon overpayments of tax shall be equal to the rate assessed by the BOE on late payments.

Since the various Special Taxes and Fees laws currently reference Section 6591.5, the interest on overpayments of taxes or fees under the Special Taxes and Fees programs administered by the BOE would also be calculated in accordance with this proposal.

The bill would become effective on January 1, 2012.

### BACKGROUND

The chart on page 5 of this analysis provides an overview of the interest rates since 1987. The July 1, 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to address the budget deficit. This legislation was prompted by a 1990 landmark decision involving new sales and use tax issues for U. S. Government contractors in California. As a result of that decision, U.S. Government contractors were entitled to refunds of overpayments of taxes previously paid to the BOE on specified transactions with the U.S. Government. Because of the potentially significant amount of tax and the period of time the overpayments occurred, it was recognized that these refunds would include a very significant amount of credit interest (note on the chart on page 4 how high the interest rates paid on refunds were at the time). With the reduced rate of interest, naturally, the state would not lose such a significant amount of revenue.

Several bills to equalize the interest rates on overpayments and underpayments have been introduced over the past several years (see chart on page 6 of this analysis), the first being in 1992, and the most recent in 2008, and many of these measures were sponsored by the BOE. However, all, except for one, were held either in a policy committee or appropriation committee due to the fiscal effect. One measure, introduced in 1992 (a year after the disparity was added into law), was passed by the Legislature, but vetoed by Governor Pete Wilson. 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.”

**COMMENTS**

1. **Sponsor and Purpose.** This bill is sponsored the BOE, upon unanimous consent of all Members of the BOE, in order increase the credit interest rate allowed on overpayments of tax, fees and surcharges, so that it matches the debit interest rate that accrues on past due tax, fee and surcharge liabilities under the BOE's programs.
2. **Issue.** The interest rate paid on overpayments was always the same as the interest rate assessed on late payments until 1991. In 1991, the credit interest rate on overpayments was significantly reduced to avoid substantial interest payments on refunds owed to the federal government and defense contractors as a result of an unfavorable court decision that entitled many United States government contractors to refunds of overpayments on taxes paid to the BOE. These refunds were paid years ago, yet the inequity in the interest rates remains. This bill is intended to eliminate the disparity that often becomes the subject of controversy between taxpayers and the BOE, and there is simply no justification now to have the 7-point discrepancy in the credit interest rate. This bill would put an end to this unfairness, by amending the law so that the same rate of interest is applied to both late payments as well as overpayments in all the BOE's tax and fee programs.
3. **IRS and FTB don't have such a disparity.** The IRS and the FTB have no disparity in interest rates for noncorporate overpayments and underpayments. The IRS has only a one percent disparity for corporate overpayments (the disparity is higher if the corporate underpayment is over \$100,000 or the corporate overpayment is exceeds \$10,000). For corporate overpayments, the FTB has a four percent disparity.
4. **Credit interest is not always allowed on 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 on the overpayment (see, for example, Revenue and Taxation Code Section 6908). This serves as a disincentive for taxpayers to purposefully overpay their taxes in order to gain interest on the overpayment.

**COST ESTIMATE**

The BOE would incur absorbable costs to implement this bill.

**REVENUE ESTIMATE****BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

Credit interest data on audits and field billing orders (FBOs) indicate that during fiscal year 2008-09, the BOE made estimated refunds of \$107 million in sales and use tax. The amount of credit interest paid on these refunded amounts was an estimated \$12 million. The interest was paid at an average rate of 4 percent. If the credit interest rate had instead been the debit interest rate of 10 percent, the BOE would have paid an estimated \$30 million in interest, an increase of \$18 million ( $\$12 \text{ million} \times 10\% / 4\% = \$30 \text{ million}$ ).

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The Special Taxes and Fees Division data indicate that during fiscal year 2008-09, the BOE paid an estimated \$5 million in credit interest on overpayments under the Special Tax and Fees programs. This interest was paid at an average rate of 4 percent. If the credit interest rate had been 10 percent, the BOE would have paid \$13 million in interest, an increase of \$8 million. ( $\$5 \text{ million} \times 10\% / 4\% = \$13 \text{ million}$ ).

Raising the interest rate paid on overpayments to the rate assessed on late payments would amount to an estimated \$26 million annually.

#### REVENUE SUMMARY

Under this bill, the BOE would have to pay an increased credit interest amount of \$26 million. Such a change in the interest rate would affect interest accrued on and after January 1, 2012; with the full revenue effect of the increased credit interest rate to be fully realized in fiscal year 2014-15.

**Qualifying Remarks.** Because the applicable credit interest rate on overpayments has been zero percent since July 1, 2009, and because credit interest is not always granted on refunded amounts, we are unable to determine the portion of the refunded amounts in fiscal year 2009-10 that would have included credit interest. Therefore, for purposes of this estimate, we used refund data from audits and FBOs for fiscal year 2008-09, where the average credit interest for that period amounted to 4 percent (data for refunded amounts initiated by the BOE outside of audits and FBOs was not readily available at the time of preparing this estimate). Also, based on historical data of refunded amounts from audits and FBOs, we believe that refunds for fiscal year 2008-09 for which credit interest was granted is representative of the level of credit interest allowances that would be granted in future years should this bill become law. We do not know what the applicable credit interest rate will be at the time these provisions will become operative. We have assumed that a minimum average differential of six percent between the debit and credit interest rates would be eliminated if this bill is enacted into law, based on historical rates over the past three years.

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

From	To	Late Payments	Overpayments
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

The following is a history of bills introduced to equalize the interest rates. Bills in **bold** were sponsored by the BOE:

Year	Legislation	Proposal	Final Status
2008	<b>AB 1926</b> , Horton	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2005	AB 1589, Villines	Equalize interest rates	Held in Assembly Appropriations Committee
2001	<b>SB 825</b> , Poochigian	Equalize interest rates	Held in Senate Revenue and Taxation Committee
2000	Stats. 2000, Ch. 607 ( <b>AB 2612</b> )	As introduced, equalize rates	Enacted to add an uncodified section that declares <b>it is the intent of the Legislature</b> to require that the interest rates to be the same
2000	<b>AB 1208</b> , AR&T Comm.	Equalize interest rates	Provisions amended out in Senate Appropriations Committee
1999	<b>AB 464</b> , Maldonado	Equalize interest rates	Held in Assembly Appropriations Committee
1997	<b>AB 222</b> , Takasugi	Equalize interest rates	Amended in the Senate to increase the credit interest rate by one percent, 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	<b>AB 1189</b> , Takasugi	Equalize interest rates	Held in the Senate Appropriations Committee
1994	<b>AB 3487</b> , Andal	Equalize interest rates	Held in the Assembly Revenue and Taxation Committee
1993	<b>AB 2083</b> , Takasugi	Equalize interest rates	Never heard in committee
1992	<b>AB 2972</b> , Mays	Equalize interest rates	Vetoed by Governor Wilson