



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date:	01/04/12	Bill No:	<a href="#">Senate Bill 950</a>
Tax Program:	Sales and Use Tax	Author:	Alquist
Sponsor:	Author	Code Sections:	RTC 7070 – 7075.9
Related Bills:		Effective Date:	Upon enactment, but operative 90 days following 1st calendar quarter

### BILL SUMMARY

This bill requires the Board of Equalization (BOE) to administer a tax penalty amnesty program for an unspecified two month period. The amnesty program would apply to

- The sales tax program, and
- The use tax program associated with qualified purchasers as that term is defined in Section 6225.

### ANALYSIS

#### CURRENT LAW

**Sales Tax.** Under existing law, except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. Every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax is required to apply to the BOE for a permit on a form prescribed by the BOE, and must file a return and pay its sales and use tax obligations. Wholesalers, as well as retailers, must obtain a permit. Under the law, a person that engages in business as a seller in this state without a seller's permit and each officer of any corporation which so engages in business, is guilty of a misdemeanor.

**Use Tax – Qualified Purchaser.** The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer for use in this state. Use tax applies to purchases by California consumers from out-of-state vendors that are not subject to the sales tax. Use tax also generally applies to leases of tangible personal property.

Effective October 23, 2009, Section 6225 of the Revenue and Taxation Code (RTC) requires “qualified purchasers” to register with the BOE and report and pay use tax directly to the BOE. “Qualified purchasers” are required to file annual use tax returns with a due date of April 15 of the following year. A “qualified purchaser” is a person who meets all of the following conditions:

- The person receives at least \$100,000 in gross receipts from business operations per calendar year.
- The person is not required to hold a seller's permit or certificate of registration for use tax under RTC Section 6226.

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- The person is not a holder of a use tax direct payment permit as described in RTC Section 7051.3.
- The person is not otherwise registered with the BOE to report use tax.

The provisions of the “qualified purchaser” program do not apply to the purchase of a vehicle, vessel, or aircraft as defined in Article 1 (commencing with Section 6271) of Chapter 3.5.

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

**Statute of Limitations.** Existing law provides different statutes of limitations for various circumstances. Generally, the statute of limitations is three years from the date the return is due or the date the return is filed, whichever is later. In the event no return has been filed, the statute of limitations is eight years from the date the return was due. If the taxpayer is guilty of fraud or intent to evade the tax, the statute of limitations is indefinite.

Although existing law generally provides the BOE the authority to determine the amounts owed for use tax going back up to eight years, upon enactment of the “qualified purchaser” program in 2009, as a matter of administrative efficiency, most “qualified purchasers” were held responsible for filing years 2007, 2008 and 2009 return periods.

**Penalties.** Under existing law, there is an array of penalties that are imposed under a variety of provisions of the Sales and Use Tax Law. The most commonly imposed penalties include:

1. For late payments generally, a penalty of 10 percent of the amount of all unpaid tax is added to any tax not paid in whole or in part within the time required by law.
2. Any person who fails to file a timely return is required to pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
3. A penalty of 10 percent of the amount of the tax specified in the determination shall be added to any determination not paid within the time required by law.

**Penalty Relief.** Under existing law, the BOE may grant relief from penalty charges imposed under RTC Sections 6476, 6477, 6479.3, 6480.4, 6480.8, 6511, 6565, 6591, 7051.2, 7073 and 7074, but not interest charges, if it is determined that a person’s failure to file a timely return or payment was due to reasonable cause and circumstance beyond the person’s control (RTC Section 6592). Sections 7073 and 7074 contain the amnesty penalty provisions.

#### PROPOSED LAW

This bill would repeal and add Article 2, commencing with Section 7070, of Chapter 8 of Part 1 of Division 2 of the Revenue and Taxation Code to require the BOE to develop and administer a sales and use tax penalty amnesty program during a two-month period currently unspecified in the bill.

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The proposed amnesty program would apply to all sales tax liabilities, and to use tax liabilities incurred by qualified purchasers as defined in Section 6225, due and payable for tax reporting periods beginning before January 1, 2012.

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

1. Files a completed amnesty application with the BOE.
2. For any taxpayer that has filed for bankruptcy protection under Title 11 of the United States Code, submits an order from a Federal Bankruptcy Court allowing the taxpayer to participate in the amnesty program.
3. Within 60 days after conclusion of the tax amnesty period, does all of the following:
  - Files completed tax returns for all tax reporting periods which have not been previously filed and files amended tax returns for all tax reporting periods in which an underreported tax liability exists.
  - Pays in full the taxes and interest due for all periods for which amnesty is requested, or applies for an installment payment agreement.
  - For taxpayers with outstanding tax liabilities due and payable for reporting periods beginning prior to January 1, 2012, pays in full the taxes and interest due for each period for which amnesty is requested, or applies for an installment payment agreement.

Additionally, a taxpayer is not eligible for amnesty if he or she is on notice of criminal investigation or a court proceeding has already been initiated as of the first day of the amnesty period.

Taxpayers may request to enter into an installment payment agreement in lieu of full payment provided the final payment under the terms of the agreement is due and is paid no later than (an unspecified date). Failure by the taxpayer to fully comply with the terms of the installment payment agreement would render the waiver of penalties null and void, unless the BOE determines that the failure was due to reasonable causes, and the total amount of tax, interest, and all penalties would be due and payable immediately.

As consideration for taxpayers participating in the amnesty program, the BOE would waive all penalties normally imposed under the Sales and Use Tax Law for the reporting periods for which tax amnesty is allowed for the nonreporting or underreporting of tax liabilities, or the nonpayment of taxes previously determined or proposed to be determined. Additionally, no criminal action shall be brought against the taxpayer for the reporting periods for which amnesty is requested in cases of nonreporting or underreporting.

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

After completion of the amnesty period, if the BOE issues a deficiency determination upon a return filed under the amnesty program or upon any other nonreporting or underreporting of tax liability by a person who could have otherwise been eligible for amnesty, the taxpayer shall be assessed penalties at a rate that is double the rate of penalties normally applicable. Any deficiency determination issued under these

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circumstances may be issued within 10 years from the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

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

This bill would require that the BOE adequately publicize the tax penalty amnesty program so as to maximize public awareness of the program.

### **BACKGROUND**

**Amnesty Programs.** In 2004, SB 1100 (Ch. 226, Stats. 2004), enacted a penalty amnesty program as part of the 2004-05 State Budget. The amnesty program applied to both sales and use tax and to franchise and income tax. The provisions for the sales and use tax program required the BOE to develop and administer a penalty amnesty program for period beginning on February 1, 2005, and ending March 31, 2005, or any other period ending no later than June 30, 2005. The amnesty program applied to sales and use tax liabilities due and payable for tax reporting periods beginning before January 1, 2003.

The provisions of the 2005 amnesty program were similar to the amnesty program proposed in this bill, except that the 2005 program applied to all sales and use tax liabilities due and payable by all persons (individual and businesses) during the amnesty period. While the proposed amnesty program applies to all sales tax liabilities, it limits the tax penalty amnesty to use tax liabilities due and payable by "qualified purchasers" as defined in Section 6225.

The 2005 amnesty program resulted in 11,682 taxpayers participating in the program and \$594.8 million received in total payments. However, approximately \$64 million of these payments remain unresolved and include unresolved appeals cases, claims for refund, and audits not yet completed.

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

**Qualified Purchaser Program.** Since its enactment in 2009, the BOE has registered over 500,000 businesses and has received over \$82 million in use tax, interest, and penalty (about \$74 million is tax) from these businesses for reporting periods 2007, 2008, 2009, and 2010. However, over half of these businesses that have filed use tax returns under this provision have reported no use tax liability and have been removed from the program.

This program was intended to address the over \$1 billion use tax gap – which, at the time, was primarily a result of unreported use tax on business-to-business transactions.

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**Use Tax Amnesty Limitation.** As proposed, the use tax penalty amnesty program is limited to the qualified purchasers program under RTC Section 6225. The proposed amnesty provisions exclude use tax liabilities due and payable by all others. These include use tax liabilities incurred by the following:

- Taxpayers who are required to hold a seller's permit and who must file sales and use tax returns to report both their sales and use tax liabilities. The use tax liability stems from purchases made from out-of-state retailers that were not otherwise taxed and on merchandise withdrawn from resale inventory for personal use.
- All individuals and those service businesses that make less than \$100,000 in gross receipts (other than "qualified purchasers.") Even though these individuals and service businesses are not generally required to register with the BOE, they are still required to report and pay tax on all purchases subject to use tax. However, if these persons regularly incur use tax liabilities on their purchases of tangible personal property, they must have a California Consumer Use Tax Account and must file tax returns with the BOE on a regular basis to pay their use tax liabilities.
- Out-of-state retailers engaged in business in California as defined in Section 6203. These retailers are required to register with the BOE and collect California use tax from their California customers and remit the use tax to the BOE by filing regular tax returns. Under existing law, such retailers are also liable for California use tax that they fail to collect from their customers and remit to the BOE.

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

## COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author and is intended to generate revenues to help close the tax gap, the difference between taxes owed and taxes paid to the State of California.

In regard to the use tax, the "qualified purchaser" program is included in the proposed amnesty program to encourage payments of the use tax due since the qualified purchaser program has not raised anticipated revenues. According to the author's office, since many individuals and small service businesses are unaware of their use tax liabilities, these entities were excluded from the proposed amnesty program to avoid imposition of the amnesty penalties that they would incur for not participating and completing the amnesty program.

2. **Proposed amnesty period unspecified.** As introduced, this bill proposes a penalty amnesty program that shall be conducted for a two-month period. However, the beginning and ending dates of the two-month period have not been specified.
3. **Qualified purchaser program not as successful as anticipated.** While this program has generated \$74 million in use tax over a four-year period, the revenues derived have been considerably short of anticipated amounts.
4. **Use tax owed by taxpayers required to register with the BOE.** Although many individuals and small service businesses may be unaware of their use tax liabilities, persons and businesses who must by law register with the BOE and who are required to file regular tax returns to report and pay their use tax liabilities are expected to be knowledgeable of such responsibilities. As such, perhaps the use tax amnesty provisions of this bill should be extended to include these taxpayers.
5. **Some taxpayers may get a second chance at amnesty.** Under this bill, the amnesty program would apply to liabilities for tax periods beginning before January 1, 2012. The 2005 amnesty program applied to tax periods before January 1, 2003. For those taxpayers that failed to come forward during the 2005 amnesty program that still have a liability, this new amnesty program would allow them one more opportunity to come forward without the risk of penalties or criminal sanctions.
6. **Technical Issues.**

**Interest Penalty Claims for Refund.** Subdivision (d) of Section 7074 provides that a taxpayer may not file a claim for refund for any amounts paid in connection with the interest penalty imposed by this bill. However, Section 6592 provides that if the BOE finds that a person's failure to pay the tax under the amnesty program was due to reasonable cause and circumstances beyond that person's control, the person may be relieved of that 50% interest penalty.

Subdivision (d) was deleted by AB 911 (Stats. 2005, Ch. 398, effective September 29, 2005) from the tax amnesty provisions enacted in 2004, to prevent some unintended consequences when taxpayers pay the 50% interest penalty before they request relief due to reasonable cause.

It is recommended that subdivision (d) be deleted from SB 950 for the same reason. Under current law, a person could be relieved of the penalty if the BOE finds that his or her failure to pay the tax was due to reasonable cause, provided the person hasn't actually paid the penalty. If the person paid the interest penalty under the provisions of this bill and then sought relief, the law would not allow a refund. The deletion of subdivision (d) would correct this inequity. It would also put the 50% interest penalty on the same footing with the same relief and refund rights, as all other penalties in the proposed amnesty program, including the other amnesty provisions which require the BOE to double the penalties if the BOE finds an underreporting or nonreporting of tax by any person who could have applied for amnesty. This would also ensure that taxpayers are afforded the same appeal rights for these penalties as any others.

**Forms and Instructions Issued by BOE.** Proposed RTC Section 7075.5 provides that the BOE shall issue forms and instructions and take other actions needed to implement the provisions of the bill. It also states that "the provisions contained in subdivision (c) of Section 19735, to the extent feasible and practical, shall also apply to the board." However, the referenced subdivision (c) does not exist. Clarification

is needed to determine if the intent was a reference to subdivision (b) of Section 19735, which provides:

Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to this chapter.

**Publicizing the Amnesty Program.** This section provides that the BOE shall coordinate to the highest degree possible its publicity efforts and other actions taken in implementing this article with similar programs administered by the FTB. Since the provisions of this bill only apply to the sales and use tax law administered by the BOE, it is recommended that reference to the FTB be deleted from this bill.

## **COST ESTIMATE**

The BOE will incur significant costs to implement this bill. Costs will include those associated with a media campaign to publicize the amnesty program, notification to the public, processing of amnesty applications, computer programming, and answering inquiries from the public. Detailed cost information is pending. But, as an order of perspective, the 2005 amnesty costs included \$2.4 million for a media campaign, and over \$3.5 million for administrative costs (described previously) for the first year; \$1.6 million the second year, and \$1.2 million in the third year.

## **REVENUE ESTIMATE**

### **BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

The proposed amnesty program would apply to all sales tax liabilities, and to use tax liabilities incurred by qualified purchasers as defined in Section 6225, due and payable for tax reporting periods beginning before January 1, 2012.

**Amnesty Program.** The 2005 amnesty program resulted in 11,682 taxpayers participating in the program and \$594.8 million received in total payments. However, approximately \$64 million of these payments remain unresolved and include unresolved appeals cases, claims for refund, and audits not yet completed.

**Qualified Purchaser Program (QP).** Since its enactment in 2009, the BOE has registered over 500,000 businesses and has received over \$82 million in use tax, interest, and penalty (about \$74 million is tax) from these businesses for reporting periods 2007, 2008, 2009, and 2010. However, over half of these businesses that have filed use tax returns under this provision have reported no use tax liability and have been removed from the program.

We estimate that this bill could generate \$129 million in amnesty revenue, including \$34 million in new sales and use tax revenue, \$2 million in use tax revenue from qualified purchasers, and \$93 million in accelerated sales and use tax revenue as follows:

AR Inventory as of 1/31/2005 <sup>1</sup>	\$1,805,710,496
Less: Penalty <sup>2</sup>	\$270,856,574
Inventory "Eligible" for Amnesty	<u>\$1,534,853,922</u>
2005 Amnesty Program Payments <sup>3</sup>	
Audit Payments	\$229,693,457
Non-Audit Payments	\$365,106,543
Total Payments	\$594,800,000
Program Payments as % of AR Inventory <sup>4</sup>	<b>38.75%</b>
AR Inventory as of 02/29/12	\$2,861,403,977
Less: Interest & Penalty Amounts	\$1,218,847,782
Inventory "Eligible" for Amnesty	<u>\$1,642,556,196</u>
Gross Amnesty Payments (38.75% of Eligible)	\$636,537,726
Less: Economic Factors (25%) <sup>5</sup>	\$159,134,431
Less: Tax Gap/ SCOP Programs (20%) <sup>6</sup>	\$127,307,545
Less: 2005 Amnesty Program (30%) <sup>7</sup>	\$190,961,318
Less: No Refund Provision (5%) <sup>8</sup>	\$31,826,886
Adjusted Amnesty Payments	<u><u>\$127,307,545</u></u>
Payment Breakdown	
Accelerated Payments (73%)	\$92,934,508
New Money (27%)	34,373,037
New Revenue QPs <sup>9</sup>	1,756,734
Total Amnesty Revenue	<u><u>\$129,064,279</u></u>

Please note this amount (\$93 million) would have been collected without the proposed amnesty program. The amnesty program would only accelerate the collection of current taxpayer liabilities.

We anticipate that taxpayer response will not be as substantial as what occurred in 2004-05 because of the numerous revenue enhancement programs we now have in place. However, based on the penalties provided, any taxpayer who could have applied for amnesty shall be subject to a penalty of 50 percent of the accrued interest for the period beginning on the date the tax was due and ending on the last day of the amnesty period. We believe this provides enough of an incentive for taxpayers to participate in the new amnesty program.

**REVENUE SUMMARY**

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

Fiscal Year Revenues

(in millions)

Amnesty Participation	2012-13	2013-14	2014-15	2015-16	Total
New Revenue	\$7	\$29			\$36
Revenue from Interest Penalty			\$2.0	\$0.5	\$2.5
Accelerated Revenue	\$15	\$78			\$93
Reduction in Revenue Stream			-\$70	-\$23	-\$93
Totals	\$22	\$107	-\$68	-\$22.5	\$38.5

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