



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

Date:	04/17/12	Bill No:	Senate Bill 1125
Tax Program:	Sales and Use Tax	Author:	Hancock
Sponsor:	BOE	Code Sections:	PCC 22120
Related Bills:		Effective Date:	01/01/13

BILL SUMMARY

This Board of Equalization (BOE)-sponsored bill requires local government entities to contract for the purchase of tangible personal property with vendors or contractors that have a valid seller’s permit or certificate of registration – use tax.

Summary of Amendments

Since the previous analysis, the bill was amended to restrict a local government entity from claiming an exemption for a “compelling local government interest” for not more than 5 percent of the total number of contract purchases of tangible personal property from a vendor or contractor in any given fiscal year.

ANALYSIS

CURRENT LAW

Under **California’s Sales and Use Tax Law**, a use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer, unless the use of that property is specifically exempted or excluded from tax.

The use tax has been in effect since 1935. It is intended to protect California sellers who would be at a competitive disadvantage when out-of-state retailers sell goods to California customers where the sale does not take place in the state and thus would not be subject to the sales tax. The use tax is imposed at the same rate as the sales tax and is generally required to be remitted to the BOE.

The use tax is imposed on the purchaser; however, if a retailer is “engaged in business in the state” within the terms of Section 6203 of the Sales and Use Tax Law that retailer is required to register with the BOE and to collect the applicable use tax on all taxable sales to California consumers.

Section 6203 describes various activities that constitute a sufficient business presence in California such that an out-of-state retailer would be considered to be “engaged in business in the state.” An out-of-state retailer who voluntarily registers with the BOE is considered to be “engaged in business in the state” even if its other activities would not constitute a sufficient business presence pursuant to Section 6203.

The **California Public Contract Code** (PCC) provides definitions and requirements for state and local government entities in procuring goods and services. Under current law, PCC Section 10295.1 requires a state department or agency to contract for the purchase of tangible personal property with a vendor or contractor, or with any affiliate of a vendor or contractor, that holds a valid seller’s permit or certificate of registration – use tax. Section 10295.1 provides an exemption from the requirements if the executive director or his or her designee of that state department or agency makes a written finding that the contract is necessary to meet a compelling state interest. For purposes

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of this provision, a “compelling state interest” includes, but is not limited to: (1) ensuring the provision of essential services; (2) ensuring the public health, safety, and welfare; and (3) responding to an emergency. This section also requires each vendor, contractor, or affiliate of a vendor or contractor that is offered a contract to do business with a state department or agency to submit to that department or agency a copy of that entity’s seller’s permit or certificate of registration.

PROPOSED LAW

This bill would add Chapter 3.3 (commencing with Section 22120) to the PCC to require local government entities to contract with a vendor or contractor, or with any affiliate of a vendor or contractor, that have a valid seller’s permit or certificate of registration. This bill would:

- Provide an exemption from the requirements if the governing body of the local government entity, or a person delegated authority by the governing body of the local government entity, makes a written finding that the contract is necessary to meet a compelling local government interest. The bill defines “compelling local government interest” to include, but is not necessarily limited to, any of the following:
 - Ensuring the provision of essential services.
 - Ensuring the public health, safety, and welfare.
 - Responding to an emergency, as defined in PCC Section 1102.
- Provide that, during any given fiscal year, a local government entity may not claim an exemption for a “compelling local government interest” for more than 5 percent of the total number of contract purchases of tangible personal property from a vendor, contractor, or an affiliate of a vendor or contractor. The bill also provides that a written finding made when claiming an exemption for a “compelling local government interest” is considered a public record for purposes of the California Public Records Act.
- Require each vendor, contractor, or affiliate of a vendor or contractor that is offered a contract to do business with a local government entity to submit to that local entity a copy of that entity’s seller’s permit or certification of registration. This provision would not apply to a credit card purchase of goods of \$2,500 or less. Total credit card purchases from a vendor exempt from this certification requirement shall not exceed \$7,500 per year.
- Define “local government entity” as a city, county, city and county, community college district, school district, or county superintendent of schools.
- Define “affiliate of the vendor or contractor” as any person or entity that is controlled by, or is under common control of, a vendor or contractor through stock ownership or any other affiliation.

The provisions of the bill would become effective on January 1, 2013.

BACKGROUND

SB 1009 (Chapter 718, Statutes 2003, Alpert) added PCC section 10295.1 for purposes of encouraging out-of-state vendors to voluntarily register to collect the California use tax. This statute requires state agencies to verify that the vendor has a valid seller's permit or is registered to collect the California use tax. If the vendor lacks a valid seller's permit or certificate of registration, the state agency is precluded from purchasing tangible personal property from the vendor unless the state agency makes a finding that the purchase is necessary to meet a compelling state need or the purchases are otherwise non-qualifying purchases as noted by statute.

SB 1009 was a use tax compliance measure intended to prevent a state agency or department from contracting for the purchase of tangible personal property with any vendor or contractor that does not have a valid seller's permit or has not registered with the BOE. It was intended to send a signal that the state of California does not wish to do business with vendors that do not collect sales and use tax on behalf of the state. By restricting a state agency from purchasing goods from out-of-state unregistered vendors, it compelled these vendors to register with the BOE and begin collecting the use tax. The California State Association of Counties (among others) supported this measure for reasons that it increases use tax payment compliance.

COMMENTS

1. Sponsor and Purpose. This bill is sponsored by the BOE in an effort to address the use tax gap. This proposal was part of the BOE's Sales and Use Tax Department's (SUTD) Tax Gap Plan, titled "[Addressing The Tax Gap,](#)" which was discussed at the August 2011 BOE meeting. The SUTD's report noted that, excluding illegal activities that are part of the underground economy, the largest portion of the tax gap is use tax liabilities. The use tax gap associated with remote sales (mail order, telephone order, or via the Internet) from out-of-state sellers is approximately \$1.2 billion annually. Of this total \$851 million is estimated to be owed by consumers and \$346 million by businesses.

This bill will promote the collection of use taxes by out-of-state sellers who do business with local government entities. While local government entities are currently self-reporting their use taxes, many out-of-state sellers doing business in California are not registered to collect the use taxes. By requiring these out-of-state sellers to register with the BOE to collect the use tax on sales to local government entities, they will also be required to collect the use tax on applicable sales of tangible personal property to all California consumers.

This measure simply imposes the same purchasing requirement on local government entities as currently imposed on state agencies. Assuming local government entities purchase tangible personal property from out-of-state vendors that are not currently registered to collect California use tax, extending the same provisions applicable to state agency purchasers to local government purchasers should result in more out of state vendors voluntarily registering to collect the California use tax.

2. The April 17, 2012 amendments (1) provide that, in any given fiscal year, a local government entity may not claim an exemption for a "compelling local government interest" for more than 5 percent of the total number of contract purchases of tangible personal property from a vendor or contractor, and (2) provide that a written finding to claim an exemption for a "compelling local government interest" is considered a public record for purposes of the California Public Records Act.

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- 3. Issue.** National consumer spending data shows that online sales are growing significantly. Based on calendar year 2010 data, the use tax gap in California, with respect to remote sales (mail order, telephone order or via the Internet) from out-of-state sellers is estimated at \$1.145 billion; of which \$795 million is estimated to be owed by consumers. In calendar year 2010, consumers reported \$10.2 million of the \$795 million in use tax due to the State of California via their Franchise Tax Board income tax return. Historically, given the low dollar amount of each transaction, it has not been deemed productive to focus on the individual transactions for enforcement purposes. Given the growth of online retail sales by out-of-state retailers and its impact on California's economy, it is necessary to find a way to encourage out-of-state, unregistered retailers to register with the BOE and collect the use tax.
- 4. Untaxed purchases from out-of-state vendors is the highest category of taxpayer noncompliance.** To comply with the requirements of the California Taxpayer's Bill of Rights, the BOE annually must: (1) identify the areas of the Sales and Use Tax Law where taxpayer noncompliance is highest and (2) classify the types of businesses making errors. For the fiscal year 2010-11, failure to pay use tax on purchases from out-of-state vendors was the highest and the most frequent category of taxpayer noncompliance. For the fiscal year 2009-10, failure to pay use tax on purchases from out-of-state vendors was the second most costly and the most frequent category of taxpayer noncompliance. In addition, for the fiscal year 2009-10, untaxed purchases from out-of-state vendors made up approximately 20 percent of net sales and use tax audit deficiencies (less refunds), totaling more than \$84.6 million in unpaid tax.
- 5. Provisions of the bill are similar to the provisions that apply to state departments and agencies.** The provisions would exempt vendors that sell to the local governments from the requirement to provide a copy of that vendor's seller's permit or certificate of registration if the purchase totals \$2,500 or less and is made on a credit card, as long as total purchases by credit card from the vendor do not exceed \$7,500 for the year. In addition, the provisions would allow a local government entity to purchase from a vendor that is not registered to collect California sales and use tax in the event the local government entity finds the purchase is necessary to meet a compelling local government interest. The bill defines "compelling local government interest" to include, but not be limited to, ensuring the provision of essential services, ensuring the public health, safety, and welfare, and responding to an emergency. This bill, however, would restrict a local government from claiming an exemption for a "compelling local government interest" for not more than 5 percent of the total number of contract purchases of tangible personal property from a vendor or contractor in any given fiscal year.
- 6. Use tax compliance is important for state and local revenue needs.** Improved collection would provide additional state and local revenues. The following table provides a breakdown of the total statewide sales and use tax rate. The statewide "base" sales and use tax rate is 7.25 percent, and is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by cities and counties and are not reflected in this chart).

<u>Rate</u>	<u>Jurisdiction</u>	<u>Purpose/Authority</u>
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)
1.0625%	State (Local Revenue Fund 2011)	Counties to fund public safety programs (RTC Sections 6051.15 and 6201.15)
0.50%	State (Local Revenue Fund)	Counties to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Counties and cities to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

To illustrate the allocation of the state and local sales and use tax revenues, if a county purchased computers for a total purchase price of \$100,000, the total amount of tax would be \$7,250 (\$100,000 x 7.25%), with:

- \$3,938 being allocated to the state's General Fund,
- \$250 being allocated to the state's Fiscal Recovery Fund,
- \$1,062 being allocated to the Local Revenue Fund 2011,
- \$500 being allocated to the Local Revenue Fund,
- \$500 being allocated to the Local Public Safety Fund, and
- \$1,000 being allocated to the applicable city or county (\$750 allocated to the applicable city or county and \$250 to the applicable county).

In addition to the base, statewide rate of 7.25 percent, cities and counties levy voter-approved transactions and use taxes (also known as district taxes) to fund general operations or to fund special programs, such as transportation, fire and police protection, hospitals, libraries, and parks and recreation. The tax rates for these district taxes range from 0.10 percent to 1.00 percent. The combined rate of district taxes levied within a county may not exceed two percent.

COST ESTIMATE

This bill does not increase administrative costs to the BOE.

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REVENUE ESTIMATE

Indeterminable, but should result in additional state and local revenue from previously unregistered out-of-state sellers.

Presumably, local governments already self-assess and pay the use tax due on their purchases of tangible personal property from unregistered out-of-state vendors. Thus, the revenue gain anticipated from this proposal is not the result of additional use tax collected from local governments, but instead is the result of sales made by out of state vendors to other California consumers. Out-of-state vendors who register with the BOE to collect the use tax would be required to collect the use tax on all applicable sales of tangible personal property to California consumers. Many of these consumers most likely would not have reported and paid the use tax due to the state.

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