

[Assembly Bill 2692](#) (Brough)

Date: Introduced

Program: Sales and Use

Sponsor: Author

Revenue and Taxation Code Article 4 (commencing with Section 7100) of Chapter 8

Effective: January 1, 2017

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Summary: Requires the Board of Equalization (BOE) and the Franchise Tax Board (FTB) to administer a tax penalty waiver program. For the BOE, the program would apply only to sales and use tax liabilities due and payable for tax reporting periods beginning before January 1, 2015.

Purpose: To open up a grace period for people who have outstanding debts and enable them to resolve those debts without risk of penalty or exorbitant fines. The author notes that the state should be focused on collecting amounts already owed rather than increasing taxes, and is concerned with the staff time spent trying to collect outstanding debts that may never be paid otherwise.

Fiscal Impact Summary: \$200.6 million, which includes \$146.5 million in accelerated payments and \$54.1 million in new revenue.

Existing Law: Existing law imposes a variety of penalties for a taxpayer's noncompliance with the Sales and Use Tax Law's various statutory requirements. These penalties include:

1. A 10% penalty generally applies to late payments and returns.
2. A 6% penalty applies to late prepayments (taxpayers with monthly taxable sales of over \$17,000 are required to make two prepayments each quarter).
3. When an underpayment is due to negligence or intentional disregard of the law or regulations, a 10% penalty applies.
4. A 25% penalty applies to a late prepayment by any motor vehicle fuel distributor or broker.
5. A 10% penalty applies to a late prepayment by any fuel producer, importer, or jobber, or 25% if the producer, importer, or jobber knowingly or intentionally fails to make a timely remittance.
6. A 50% penalty applies to a vehicle, vessel or aircraft purchaser who registers the item outside this state to evade the tax.
7. A 25% penalty applies in fraud cases.
8. A 50% penalty applies to any person who knowingly fails to obtain a valid permit prior to the date in which the first tax return is due when the monthly taxable sales for the period averaged more than \$1,000.
9. A 10% penalty or a \$500 penalty applies when any person knowingly issues a resale certificate for personal gain or to evade the payment of taxes while not actively engaged in business as a seller.
10. A \$500 penalty applies to any person that sells to a catering truck operator who fails to obtain evidence that the operator holds a valid seller's permit.
11. A \$500 penalty applies to a retail florist who fails to obtain a seller's permit before engaging in or conducting business as a seller.

In addition to any applicable penalties, existing law requires the BOE to impose a 6% monthly interest rate for any payments made after the statutory due date. Simple interest accrues on the late tax payment from the tax due date to the last day of the month in which it is paid.

Under existing law, the BOE administers a voluntary disclosure program,¹ which allows unregistered out-of-state retailers and California purchasers to voluntarily register with the BOE and limit their liability for

¹ Revenue and Taxation Code Sections 6487.05 and 6487.06.

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 a return and report that tax, the law allows the BOE to issue a deficiency determination for tax, interest, and penalties owed for the last eight years. Under this program, if an out-of-state retailer or California purchaser qualifies, the billing period is limited to three years, and the BOE is authorized to grant penalty relief.

Proposed Law: This bill requires the BOE and the FTB to administer a tax penalty waiver program for a three-month period beginning on February 1, 2017 and ending April 30, 2017, or any other period ending no later than June 30, 2017. For the BOE, the proposed waiver program would apply to sales and use tax liabilities due and payable for tax reporting periods beginning before January 1, 2015.

The proposed tax waiver program applies to any taxpayer who meets the following requirements:

1. Files a completed waiver application with the BOE, signed under penalty of perjury.
2. For any taxpayer that has filed for bankruptcy protection under United States Code Title 11, submits an order from a Federal Bankruptcy Court allowing the taxpayer to participate in the waiver program.
3. Within 60 days after conclusion of the tax penalty waiver 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 penalty waiver is requested, or applies for an installment payment agreement.
 - If the person is a taxpayer with an outstanding tax liability (an accounts receivable balance) due and payable for reporting periods beginning prior to January 1, 2015, pays in full the taxes and interest due, or applies for an installment payment agreement.

Taxpayers may request to enter into an installment payment agreement in lieu of full payment, provided the final payment under the agreement's terms is paid no later than June 30, 2018. A taxpayer's failure to fully comply with the installment payment agreement would make the penalty waiver null, and void and the total amount of tax, interest, and all penalties would be due and payable immediately.

In consideration of a taxpayer's participation in the penalty waiver program, the BOE may waive all applicable penalties for the reporting periods. Additionally, in cases of non-reporting or underreporting, the taxpayer shall not be subject to criminal action for the reporting periods where the taxpayer requested a penalty waiver, unless the taxpayer is on notice that a criminal investigation or a court proceeding is pending as of the first day of the waiver period.

The BOE may not grant a penalty refund or credit paid prior to the time the taxpayer makes a penalty waiver request.

This bill requires that the BOE adequately publicize the penalty waiver program so as to maximize taxpayers' program awareness.

Background: California has implemented two similar penalty waiver ("amnesty") programs in the past. The most recent was enacted in 2004,² commenced February 1, 2005, and ended on March 31, 2005. Under this program, enhanced penalties also applied to unpaid liabilities of taxpayers who failed to take advantage of the amnesty program, as follows:

- After completion of the amnesty period, if the BOE issued a deficiency determination upon a return filed under the amnesty program or upon the non-reporting or underreporting of tax by any person who could have otherwise been eligible for amnesty, taxpayers were assessed penalties at a rate double the penalty rate normally applicable.

² SB 1100 (Ch. 226, Stats. 2004).

- Also, the BOE could issue any deficiency determination under the above circumstance up to 10 years.
- In addition, taxpayers who could have applied for amnesty were subjected to a 50% penalty of the accrued interest for the period beginning on the tax due date and ending on the amnesty period's last day.

California's first and only other penalty waiver program was enacted in 1984.³ This 94-day amnesty program began December 10, 1984 and ended March 15, 1985. The program also contained enhanced penalties and enforcement tools that applied after the amnesty program's expiration.

As part of the Fiscal Year 2002-03 California budget, legislation was enacted⁴ that authorized the BOE, to waive penalties *and* interest if a taxpayer paid in full his or her past due tax liability by a specified date, if the BOE determined it was in the State's best interest. This measure limited the eight-month program (October 2002 through June 2003) to unpaid tax liabilities that the BOE determined to be "high-risk" collection accounts. In general, these accounts were either already written-off, or about to be written-off as uncollectible.

Commentary:

- 1. Effect of the bill.** For unpaid, unreported, or underreported sales and use tax liabilities due before January 1, 2015, this bill waives penalties and criminal action against taxpayers who file a penalty waiver application and, by June 30, 2018, pay their outstanding amounts.
- 2. Bill could encourage taxpayers that have existing liabilities with the BOE to come forward.** In addition to extending the penalty waiver opportunity to taxpayers who may never have reported their sales or use tax liabilities, or who have underreported their liabilities, this bill also extends the penalty waiver opportunity to those taxpayers that have existing unpaid accounts receivable balances with the BOE that were due prior to January 1, 2015. As of December 31, 2014, the outstanding sales and use tax accounts receivable balance was over \$3 billion.⁵
- 3. No consequences for a taxpayer's failure to come forward.** Unlike previous waiver ("amnesty") programs that had post-amnesty enforcement provisions and enhanced penalties in connection with a taxpayer's failure to come forward during the amnesty period, this bill contains no such post amnesty enhancements.

Administrative Costs: Specific costs are pending. However, the BOE will incur significant costs if this bill becomes law. These costs include public notification, waiver application and return processing, computer programming, and answering public inquiries. For perspective, the BOE's costs associated with the 2003-04 penalty amnesty program amounted to about \$6 million the first year (which included funding for a media campaign), \$1.6 million the second year, and \$1.2 million the third year.

Revenue Impact:

Background, Methodology, and Assumptions. The BOE and the FTB administered a similar program during fiscal year 2004-05. The revenue, including both tax and interest, collected under that program was as follows:

<u>Agency</u>	<u>Amount (in millions)</u>	<u>Percent of Total</u>
FTB	\$714.0	54%
BOE	<u>600.2</u>	46%
Total	<u>\$1,314.2</u>	

³ AB 3230 (Ch. 1490, Stats. 1984).

⁴ AB 2065 (Ch. 488, Stats. 2002).

⁵ Includes \$845 million in non-final liabilities, such as protested amounts.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

The above total includes audit-related revenue that the BOE’s staff had already identified but not yet billed. The split between audit-related and non-audit-related dollars was:

<i>Audit Payments</i>	\$439,8
<i>Non-Audit Payments</i>	\$160,4
	<u>\$600,2</u>

This bill includes audit-related billed liabilities, and self-assessments, as well as non-audit related taxpayer liabilities. Since the 2004-05 program, the accounts receivable (AR) inventory has increased by 67% between the period January 2005 and March 2016. The economic downturn during 2007-09 contributed greatly to this 53% increase.

Since the 2004-05 program, the BOE has additional compliance programs that assist in closing the tax gap and lowering AR inventories. For example, the Statewide Compliance and Outreach Program (SCOP) focuses on educating businesses, as well as identifying and registering businesses who are actively selling or leasing tangible personal property in California without a seller’s permit. These economic factors, such as the economic downturn and the BOE’s enhanced compliance efforts, and the relatively short period since the 2004-05 program have a significant impact on this bill’s estimated revenue potential. The estimated revenue impact is:

AR Inventory as of 1/31/2005 ⁶	\$1,805,710,496
Less: Penalty ⁷	\$270,856,574
Inventory "Eligible" for Amnesty	\$1,534,853,922
2005 Amnesty Program Payments ⁸	
Audit Payments	\$231,781,107
Non-Audit Payments	\$368,424,943
Total Payments	\$600,206,051
Program Payments as % of AR Inventory ⁹	39.11%
AR Inventory as of 12/31/2014	\$3,017,833,469
Less: Interest & Penalty Amounts	\$452,675,020
Inventory "Eligible" for Amnesty	\$2,565,158,449
Gross Amnesty Payments (39.27% of Eligible)	\$1,003,107,592
Less: Economic Factors (25%) ¹⁰	\$250,776,898
Less: Tax Gap/ SCOP Programs (20%) ¹¹	\$200,621,518
Less: 2005 Amnesty Program (25%) ¹²	\$250,776,898
Less: No Refund Provision (5%) ¹³	\$50,155,380
Less: No Enhanced Penalties ¹⁴	\$50,158,380
Adjusted Amnesty Payments	\$200,621,518

⁶ Source: SUTD AR Inventory Report. Includes amounts in District and HQ Control, Non-final liabilities, and liabilities in Pending Write-off Status.

⁷ Based on 2009 AR inventory, estimate that 15% of AR Inventory represents unpaid penalty amounts. Penalty adjusted off since amnesty participants did not pay penalty amounts.

⁸ 2005 Amnesty Program payments as of 3/31/2010

⁹ 2005 Amnesty Program Payments divided by Inventory Eligible for Amnesty

¹⁰ SUTD AR Inventory has increased by approximately 67% from January 2005 to March 2016, a significant amount of this amount resulted from the Great Recession from 2007-09. In fact, 53% of the growth occurred between the period January 2015 and July 2009. Accordingly, significantly less taxpayers did not have resources available to pay tax amount of a liability resulting from increased property foreclosures, business closures, and increased unemployment. We don't believe that many of these liabilities will be repaid

¹¹ Anticipate BOE's Tax Gap and SCOP Programs will reduce amnesty payments received

¹² BOE offered an Amnesty Program in 2005. We anticipate this will reduce the number of participants (and associated payments) should another Amnesty program be offered intervened by the Great Recession

¹³ No provision for taxpayers to file a claim for refund for any overpayment of tax under the amnesty will reduce the number participants

¹⁴ Unlike the 2005 program, AB 2692 has no enhanced penalties for taxpayers' failure to participate

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Revenue Summary The estimated revenue that would be derived from the proposed tax penalty waiver program is:

Tax Penalty Waiver Program	
Accelerated Payments (73%)	\$146,453,708
New Revenue (27%)	54,167,810
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Total Revenue Impact	<u>\$200,621,518</u>

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