Draft

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Enrolled**	Bill No:	**AB 969**
Tax:	**Sales and Use**	Author:	**Eng**
Related Bills:		Position:	**Support – Board sponsored**

BILL SUMMARY

This Board of Equalization (Board)-sponsored bill would *require* consumers who have failed to report use tax to the Board on their taxable purchases for the preceding year to report the use tax on the income tax returns for the taxable year in which the liability for the qualified use tax was incurred. This bill would also eliminate the January 1, 2009 sunset date on the provisions which provide for the separate line on the Franchise Tax Board (FTB) income tax returns for use tax reporting.

ANALYSIS

CURRENT LAW

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is required to be remitted to the Board of Equalization (Board) on or before the last day of the month following the quarterly period in which the purchase was made. Generally, a use tax liability occurs when a California consumer or business purchases tangible items for their own use from an out-of-state retailer that is not registered with the Board to collect the California use tax. Generally, when a person is late in payment of his or her use tax obligations, the Board imposes a 10 percent penalty, plus interest, currently at the rate of 11 percent per year.

In an effort to increase the public's awareness of the use tax and to encourage voluntary compliance in reporting the use tax, legislation enacted in 2003 (SB 1009, Ch. 718), required the FTB to revise the personal income tax and corporations tax returns to add a separate line for use tax reporting. While the use tax law was enacted in 1935, this was the first time a line to report use tax appeared on the state's income tax returns. This legislation allowed consumers to *elect to* report use tax on their income tax returns for purchases made on or after January 1, 2003, and through December 31, 2009, as an alternative to reporting the tax to the Board (certain consumers and retailers already registered with the Board, however, may not use this alternative).

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 Board's formal position.

PROPOSED LAW

This bill would amend Sections 6452.1, 6487.3, and 18510 of the Revenue and Taxation Code to require persons, except as specified, who have failed to report their use tax obligations to the Board on taxable purchases during the taxable year in which the FTB return is required to be filed, to report their use tax liability on that return.

The bill would additionally exclude from its provisions, any person who is registered with the Board as a cigarette and/or tobacco products consumer.

The bill would also require FTB to revise the accompanying instructions for filing FTB returns in a form and manner approved by the Board.

The bill would become effective on January 1, 2008, and would apply to taxable purchases made during the calendar year 2007 for which use tax was not paid to the Board.

The bill contains legislative intent language to specify that the same rights under the Sales and Use Tax Law shall apply to payments of use tax made on the FTB returns.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board in an effort to increase taxpayers' as well as tax practitioners' compliance with the use tax laws. In an FTB analysis of individual returns from tax year 2003, it found that taxpayers who self-prepared their returns were nearly eight times more likely to declare use tax than those who used a tax practitioner. Nearly 63 percent of all individual returns FTB received were practitioner-prepared. Yet, only 16.6 percent of all use tax declarations were made on practitioner-prepared returns. While the dollar amount of use tax reported on the FTB returns is increasing (in 2004, use tax of $2.8 million was reported, in 2005, $4.6 million, and in 2006, $5.5 million was reported), voluntary compliance is still very low. The Board has estimated that the total annual dollar amount of unreported use tax is over $1 billion (unreported use tax by consumers is estimated to be over $400 million, and for businesses not registered with the Board, over $600 million). Instead of having an option to either report to the Board or to the FTB, this measure would *require* consumers and businesses that aren't already registered with the Board to report their use tax obligations to the FTB if they failed to report the tax to the Board during the preceding taxable year.

   One of the reasons that practitioner-prepared returns do not reflect use tax is that some tax practitioners believe that they can disregard their ethical obligation to inquire about a client's use tax obligation when preparing a client's income tax returns, since the income tax return form and instructions simply provide for an election to report the tax. This bill is seeking to dispel this misconception by eliminating the election to report on the FTB return. Instead, the bill would specify that the tax is *required* to be reported on that return if the purchaser failed to already report the tax to the Board. These provisions would not, however, preclude the Board from making any determinations for qualified use tax against any persons in accordance with the current provisions of the Sales and Use Tax Law.

   It is anticipated that these proposed changes would enable tax practitioners, consumers, and business entities not registered with the Board to have a better understanding of their obligation to properly report use tax liabilities. In return, the competitive disadvantage in-state retailers have compared to out-of-state retailers that are not required to collect the California use tax may be improved.

2. **Enactment of this bill would exclude persons registered with the Board as cigarette and tobacco products consumers.** Under current law, persons that have a reporting obligation to the Board are not allowed to report their use tax obligations on their FTB returns. Instead, they are required to remit their taxes directly to the Board (see Section 6452.1 (i)(1)). This bill would additionally specify that the use tax attributable to certain cigarette and tobacco products consumers' purchases is not "qualified use tax" for purposes of reporting the tax on the FTB return. This relates to a program the Board recently implemented to collect taxes due on purchases of cigarettes and/or tobacco products from out-of-state sellers.

   Under this program, the Board registers consumers that acquire these products from out-of-state retailers without payment of the state excise taxes or use tax (the Board uses purchaser information provided by sellers who comply with the federal Jenkins Act, which requires sellers to provide purchasers' names and addresses). Under this program, consumers are required to file returns with the Board and pay all applicable excise and use taxes due. (There are two types of excise taxes administered by the Board that are imposed on cigarettes and tobacco products distributed in California: 1) the cigarette tax, and 2) the cigarette and tobacco products surtax). Therefore, those consumers registered by the Board under this program would be excluded from the provisions of the bill.

3. **No new penalties would be imposed.** This measure would not impose any new penalties for a person's failure to pay the use tax on the FTB return, or to the Board. Current law already provides for a 10 percent penalty, as well as interest (and has done so since 1935), for a person's late payment of the tax.

4. **Many other states allow for use tax reporting on income tax returns.** Of the 38 states that impose both an income tax and a use tax on purchases of tangible personal property, 21 states provide for individuals to report their use tax obligations on their income tax return.

COST ESTIMATE

The Board's costs associated with this measure would be commensurate with the number of additional returns that would be filed with FTB (currently the Board incurs personnel costs for collecting the unpaid use tax reported on the FTB returns, refunding use tax reported in error, answering questions from taxpayers about the use tax, and allocating the local and district taxes included in the tax reported on the FTB returns). However, we anticipate that the additional revenue would substantially exceed the additional costs.

Since the line was incorporated into the FTB returns, the Board has reimbursed FTB for associated costs, as shown below. Our projected costs for fiscal year ending 2007 are estimated to be approximately $260,000, and we can anticipate similar costs in future years, and perhaps more, depending on the number of additional returns filed with use tax declared.

2003-04	$1,007,316
2004-05	237,038
2005-06	260,854

REVENUE ESTIMATE

If enacted, we hope to obtain better compliance by taxpayers and tax practitioners in reporting use tax obligations by making it clear that use tax must be reported on the FTB return if it hasn't already been reported to the Board. However, it is difficult to measure in dollar amounts the extent to which increased compliance would occur. By eliminating the January 1, 2009 sunset date, however, we can expect to continue receiving at least an estimated $6 million annually on an ongoing basis.

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