



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/12/08	Bill No:	AB 1926
Tax:	Sales and Use Special Taxes	Author:	Horton & Denham
Related Bills:		Position:	Support as Sponsor

BILL SUMMARY

This Board-sponsored bill would revise the interest calculation provisions in Board-administered tax and fee programs so that the same rate of interest is applied to both underpayments and overpayments of tax.

ANALYSIS

CURRENT LAW

Under existing law, persons who pay their tax and fee (hereinafter tax) obligations after the date they are due are required to pay a penalty (10 percent of the tax), plus interest on the unpaid tax from the date the tax was due to the date it was paid. Persons who have overpaid their tax to the state are granted credit interest on the overpayment (when it is determined that the overpayment was not intentional or a result of carelessness) from the first day of the calendar month following the month during which the overpayment was made to either the last day of the month following the date upon which the refund is approved by the Board, or the date the claimant is notified by the Board that a claim may be filed, whichever is earlier.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the Board to taxpayers on overpayments of tax and the rate of interest paid by taxpayers to the Board on underpayments of tax. However, AB 2181 and SB 179 (Statutes 1991, Chapters 85 and 88, respectively) significantly changed the computation of *credit* interest (interest paid on overpayments of tax) under Section 6591.5 of the Sales and Use Tax Law. Those measures provided that, instead of calculating interest on overpayments based on specified provisions of the Internal Revenue Code, plus three percentage points as interest on underpayments continued to be calculated, the interest on overpayments was based on the bond equivalent rate of 13-week treasury bills auctioned. The rate for interest on underpayments is presently set at 11 percent, and the rate for interest on overpayments is presently 5 percent through June 30, 2008. Therefore, under current law, there is presently a 6 point difference in the rate of interest paid on overpayments and the rate of interest assessed on underpayments.

PROPOSED LAW

This bill would amend Section 6591.5 of the Sales and Use Tax Law to require that interest paid with respect to both underpayments and overpayments of tax be calculated at the same modified adjusted rate per annum, determined by specified provisions of the Internal Revenue Code, plus three percentage points. Since all of the Special Taxes laws currently reference Section 6591.5 with respect to the rate of interest on both underpayments and overpayments, the interest on both underpayments and

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overpayments of taxes and fees under the Board-administered Special Taxes programs would also be calculated in accordance with this bill.

BACKGROUND

The 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to resolve the budget deficit at that time. That legislation was prompted by the decision in *Aerospace Corporation v. State Board of Equalization* (1990)218 Cal.App.3d 1300 involving sales in California to the federal government by U. S. Government contractors. As a result of that decision, U.S. Government contractors were entitled to refunds of overpayments of taxes previously paid to the Board on specified transactions with the U. S. Government. Because of the potentially significant amount of tax and the period of time over which the overpayments occurred, these refunds would have included a considerable amount of credit interest. Accordingly, by reducing the interest rate, the state did not lose as much revenue as it otherwise would have.

Since then, numerous bills have been introduced to eliminate the disparity in the rates of interest on underpayments and overpayments. The following is a history those:

Year	Legislation	Final Status
2005	AB 1589, Villines	Held in Assembly Appropriations Committee
2001	SB 825, Poochigian	Held in Senate Revenue and Taxation Committee
2000	Stats. 2000, Ch. 607 (AB 2612)	Enacted to add an uncodified section that declares it is the intent of the Legislature to require that the interest rates be the same
2000	AB 1208, AR&T Comm.	Provisions amended out in Senate Appropriations Committee
1999	AB 464, Maldonado	Held in Assembly Appropriations Committee
1997	AB 222, Takasugi	Amended in the Senate to increase the credit interest rate by one percent, but held in the Senate Appropriations Committee
1995	AB 397, Hannigan	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	Provisions amended out in Assembly Revenue and Taxation Committee
1995	AB 1189, Takasugi	Held in the Senate Appropriations Committee
1994	AB 3487, Andral	Held in the Assembly Revenue and Taxation Committee
1993	AB 2083, Takasugi	Never heard in committee
1992	AB 2972, Mays	Vetoed by Governor Wilson

Since the 1991 legislation that revised the interest rates, the debit and credit interest rates have ranged from 14% and 6% respectively, down to 7% and 1% respectively.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board of Equalization in an effort to eliminate the disparity that currently exists in the rate of interest charged on underpayments and the rate of interest paid on overpayments. This disparity often becomes the subject of controversy between taxpayers and the Board. The entire basis for the lower credit interest rate was to reduce the amount of interest associated with refunds the state was required to pay as a result of an unfavorable court decision. Since the settlement agreement for repayment of the refunds has been finalized for years, there is simply no justification now for the overpayment interest rate to be different from, and considerably lower than, the underpayment interest rate, a difference presently of 6 points. The Board is sponsoring this measure to put an end to this unfairness by amending the law so that the same rate of interest is applied to both underpayments and overpayments in all the tax and fee programs the Board administers
2. **Other major taxing agencies don't have such a disparity.** According to the Franchise Tax Board, its interest rate on both underpayments and overpayments is the same - 8 percent compounded daily. However, for corporate overpayments, the interest rate is 5 percent.

The Internal Revenue Service interest rates are:

- 7 percent for overpayments (6 percent in the case of a corporation)
 - 7 percent for underpayments
 - 9 percent for large corporate underpayments
 - 4.5 percent for the portion of a corporate overpayment exceeding \$10,000
3. **This bill is consistent with the Legislature's stated intent to correct the interest rate disparity.** Assembly Bill 2612 (Statutes of 2000, Chapter 607,), as enacted, provides that it is the intent of the Legislature to require that the rate of interest accruing on both overpayments and underpayments of sales and use tax be determined in the same manner.
 4. **This bill would *not* change interest charged on *late* payments of taxes.** This bill would not change the rate of interest charged on late payments (underpayments) of tax. It is intended to only, and will only change, the interest rate paid on overpayments. Therefore, the incentives provided in the law to encourage prompt payment of taxes would remain intact and would not be affected by the enactment of this measure.

COST ESTIMATE

Notifying taxpayers, revising forms and publications, and programming costs would be incurred in order to change the credit interest rate. A cost estimate is pending.

REVENUE ESTIMATE

During fiscal year 2006-07, the Board made refunds of \$301.6 million in sales and use taxes to which credit interest applied. The amount of credit interest paid on these refunded taxes was \$20.9 million. This interest was paid at an annual average rate of 4.5%. If the credit interest rate had instead, been the debit interest rate of 10.5%, the Board would have paid \$48.8 million in interest, an increase of \$27.8 million. ($\$20.9 \text{ million} \times 10.5\% / 4.5\% = \48.8 million).

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The Board also paid approximately \$1 million in credit interest on refunds under the Special Taxes programs. This interest was paid at an annual average rate of 4.5%. If the credit interest rate had been, instead, the debit interest rate of 10.5%, the Board would have paid \$2.3 million in interest, an increase of \$1.3 million. ($\$1 \text{ million} \times 10.5\% / 4.5\% = \2.3 million).

Since a change in the interest rate would affect interest accrued only after the effective date of any legislation, the full effect of changing the credit interest rate will take a number of years to be fully realized, as follows:

Estimated Increased Credit Interest Payments
if Credit Interest was equal to Debit Interest

Year	State		Total	Local	District	Total
	Special Taxes	Sales & Use Tax				
2008-09	109,000	1,540,000	1,649,000	587,000	202,000	2,438,000
2009-10	777,000	11,003,000	11,780,000	4,192,000	1,446,000	17,418,000
2010-11	1,290,000	18,265,000	19,555,000	6,958,000	2,401,000	28,914,000
2011-12	1,300,000	18,412,000	19,710,000	7,010,000	2,420,000	29,140,000

Analysis prepared by: Sheila T. Waters 445-6579 02/29/08

Revenue estimate by: Bill Benson 445-0840

Contact: Margaret S. Shedd 322-2376

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