



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

DRAFT

Date Amended:	04/03/08	Bill No:	<u>AB 2152</u>
Tax:	Sales and Use	Author:	Duvall
Related Bills:			

BILL SUMMARY

This bill would require the Board, if the security deposit posted by a taxpayer is not refunded after a three year period, as specified, to pay interest to the taxpayer on the amount of that security based on the rate computed on underpayments of sales and use tax. Also, the bill would allow a taxpayer to bring a legal action against the Board if the Board fails to refund the security deposit, as specified.

ANALYSIS

CURRENT LAW

Under existing law, Section 6701 of the Sales and Use Tax Law allows the Board, whenever it deems it necessary to insure compliance with the Sales and Use Tax Law, to require taxpayers to place with it such security that the Board may determine. The amount of the security is fixed by the Board but shall not be greater than twice the estimated average liability of persons filing returns for quarterly periods or three times the estimated average liability of persons required to file returns for monthly periods, or \$50,000, whichever amount is the lesser.

Existing law requires that security held by the Board be released after a three-year period in which the taxpayer has filed all returns and paid all amounts of tax required to be paid to the state within the time required. Current law does not authorize the state to pay interest on any security held pursuant to Section 6701.

PROPOSED LAW

This bill would amend Section 6701 of the Sales and Use Tax Law to specify the following:

- 1) If the Board does not release the security to the taxpayer after the three-year period in which the taxpayer has filed all returns and paid all tax to the state or any amount of tax required to be collected and paid to the state within the time required, the Board shall also pay interest to the taxpayer upon the amount of security at the same rate established for underpayments of tax to the state, as specified (currently at a rate of 11 percent annually).
- 2) If the Board does not release the security to the taxpayer within three months of the date upon which the security was eligible for release, a taxpayer may bring a suit or proceeding in any court for the recovery of a security deposit alleged to have been erroneously withheld by the Board. If the taxpayer is the prevailing party, they shall be entitled to the recovery of their reasonable legal fees and court costs.

The bill would become effective January 1, 2009.

BACKGROUND

This bill was prompted by some recent news articles about the Board's policies and procedures related to the refunding of, or the releasing of, security deposits posted by taxpayers. After receiving a call from a San Diego business owner who paid the security deposit, Board Member Michele Steel requested staff to report on the scope and magnitude of the delays in processing the return of security deposits, and asked the staff to immediately release any security deposits eligible for release.

Up until recently, the Board had a fairly strict policy related to conditions under which the Board would release a security deposit to a taxpayer after the three-year period.

However, pursuant to Board Member Steel's request, in January, 2008, staff prepared an agency-wide action plan to evaluate all aspects of the Board's security deposit policy and procedures. As a result, staff determined that many of the taxpayer accounts for which deposits had been held by the Board under those policies were actually in good standing, and that the taxpayers should be entitled to a release of their deposits. Therefore, as of March 27, 2008, the Board has released a total of 5,266 security deposits worth over \$42 million (as of December, 2007, the Board had a total of 31,179 accounts with active security for a total of over \$436 million).

The release of the backlogged security deposits has recently been completed, and staff is now focusing on improving the current policies and procedures from the time the security is requested through the time it is released. The goal is to streamline the security application and release process and to create a process that is more uniform, timely, and efficient. Beginning April 1, 2008, all district offices and Headquarters units will review and release security deposits on a monthly basis (previous policies were to review three-year old security deposits every 6 months).

IN GENERAL

For each tax program administered, the Board is either required or authorized to obtain security, within certain limitations, to ensure payment of any tax that might become due or delinquent. When security is deemed necessary, a minimum security deposit of \$2,000 has been set by Board policy for sales and use tax accounts, and the maximum is set by law. The maximum for sales and use tax accounts is determined for each account by using the "estimated average tax liability" and may not exceed \$50,000.

In determining whether or not security is necessary to protect the interests of the state, the Board considers such factors as:

1. The applicant's payment history, if any, with the Board.
2. Type of ownership — sole proprietor and partnerships consisting of individuals are generally a lower risk than other types of ownership.
3. A corporation's financial condition. If the corporation owns real estate in which there is sufficient equity to secure future tax obligations, security may be waived.
4. History record of the individual forming a new closely held corporation. If the individual forming the closely held corporation has established a prior good payment history with the Board, then the security may be waived.

Security that is accepted by the Board can be in the form of a cash deposit, liquid security deposits (i.e., time certificates of deposit, state and federal credit union shares), surety bonds, and/or guaranties.

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.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by Board Member Steel in order to provide some reasonable remedies to taxpayers who have posted security with the Board when those taxpayers' accounts are in good standing with the Board after a three year period.
2. **From what date and from which account would the interest be paid?** The bill does not specify from what date the interest would accrue. For example, if the security deposit is eligible for release on March 1, 2009, would interest begin accruing from that date until the date the release is approved? It is our understanding that the intent is to allow the Board 90 days after the three-year period to identify the accounts that have posted security and initiate the release. Accordingly, the language shown on the attachment as amendment 1 would address this issue.

Also, since securities are not deposited into the Retail Sales Tax Account (cash deposits are held in a non-interest bearing checking account of the Board's, and other security is generally held by the taxpayer's financial institution or bonding agency), it is unclear from what account any interest required to be paid on the refunded or released security would come. If it is the intent to allow for payment of the interest from the Retail Sales Tax Account, the language shown on the attachment as amendment 2 would address this issue.

3. **What if the taxpayer has filed all returns and paid all the tax, but the account is still not in "good standing?"** Under current policies adopted by the Board, even if a taxpayer has filed all returns and paid all the tax due to the state within the time required, security is released only after a three-year period in which the taxpayer's account is in good standing. "In good standing" generally means the taxpayer has no more than three instances of either late payments or delinquent returns within the last 12 months of the 3-year period, has filed all returns, paid all amounts required to be collected, and has no current unpaid proposed liabilities.

The Board has adopted these guidelines in order to protect the state's interests. It is suggested that the bill be amended to enable the Board to continue to exercise its discretion in withholding the release of security when the Board determines that the taxpayer's account is not in good standing under policies adopted by the Board. Absent such a provision, in lieu of paying interest and dealing with lawsuits, related court costs and attorney fees, the Board would essentially be placed in the position of releasing security on some accounts that ultimately default on their tax payments.

4. **Is this bill necessary at this point?** The staff has diligently worked to release the backlog of securities that had been held under the old policies and procedures, and has issued directives to all district and headquarters staff to comply with the recently adopted guidelines and procedures in releasing security deposits. Before enacting legislation, perhaps the Board's implementation and administration of the new policies and procedures should be observed, and any unresolved or unexpected concerns that develop in the future be addressed.

COST ESTIMATE

Enactment of this measure would not materially affect the Board's administrative costs.

REVENUE ESTIMATE

If the bill were amended to address the issues identified in the comments above, we would expect that a very minor amount, if any, interest would be paid, as the conditions under which the provisions of the bill would impose interest or allow suit for refund of security should occur rarely, if ever. However, should the bill *not* be amended to address these concerns, there could be a potential risk in collecting amounts due from some taxpayers whose security was released prematurely under the provisions of the bill.

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PROPOSED AMENDMENTS TO AB 2152

Amendment 1. On page 3, line 16, after "6591.5." insert the following:

Interest shall be computed beginning on the first day of the first calendar month following the 90-day period immediately following the three-year period and ending on the last day of the month in which the security is released by the Board.

Amendment 2. On page 3, the following language is recommended

Section 7102 of the Revenue and Taxation Code is amended to read:

7102. The money in the fund shall, upon order of the Controller, be drawn therefrom for refunds under this part, credits or refunds pursuant to Section 60202, payments of interest pursuant to Section 6701, and refunds pursuant to Section 1793.25 of the Civil Code, or be transferred in the following manner:

(a) (1) All revenues, less refunds, derived under this part at the 43/4-percent rate, including the imposition of sales and use taxes with respect to the sale, storage, use, or other consumption of motor vehicle fuel which would not have been received if the sales and use..