



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/15/10	Bill No:	AB 2556
Tax:	Sales and Use	Author:	Fuller
Related Bills:	AB 2375 (Knight) SB 1028 (Correa)		

BILL SUMMARY

This bill would authorize the Board, meeting as a public body, to relieve all or part of the interest imposed on a person, as described, where use tax is remitted to the Board within 90 days of the Board notifying the person of a nonpayment of use tax, when that notification is made as a result of the Board obtaining information with respect to the liability from the United States Customs Service.

SUMMARY OF AMENDMENTS

The amendments to this bill since our last analysis specify that the Board, meeting as a public body, may relieve a person from the interest under the terms of the bill. These amendments also limit the interest relief authorized under the bill to those persons whose gross receipts from business operations is less than \$250,000, or if the person has no business operations, whose gross adjusted income is less than \$250,000.

ANALYSIS

CURRENT LAW

Since 1935, existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code has imposed 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. 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 or foreign 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 law imposes a 10 percent penalty, plus simple monthly interest, currently at the rate of seven percent per year.

Voluntary compliance with the use tax law by many businesses and individuals is low. In effort to increase the public's awareness of the use tax and to encourage voluntary compliance in reporting the use tax, for the past seven years, the state income tax returns (both personal income tax and corporation tax) have contained a separate line and accompanying instructions in the booklet for use tax reporting. Few purchasers report their use tax this way - last year, less than .03% of state income tax returns filed contained use tax.

Under existing law, the Board has authority to relieve a late payment penalty when the Board finds that the taxpayer's failure to make a timely payment is due to reasonable cause and circumstances beyond the person's control. However, interest on the late payment is generally not relievable (except in cases of a disaster or where the failure to pay the tax timely was due to an unreasonable error or delay by a Board employee or a

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.

Department of Motor Vehicles employee under specified circumstances). Consequently, aside from these exceptions, and regardless of the reason, current law requires that interest accrue from the due date of the tax until the end of the month in which the tax was paid.

PROPOSED LAW

This bill would amend Section 6593.5 of the Sales and Use Tax Law to allow the Board, meeting as a public body, to relieve all or part of the interest imposed on use tax that is remitted to the Board within 90 days of the Board notifying the taxpayer of the nonpayment of use tax, when that notification is made as a result of the Board obtaining information with respect to the liability from the United States Customs Service. The bill would limit the Board's authority to provide relief to those persons whose gross receipts from business operations are less than \$250,000, or if the person has no business operations, whose gross adjusted income is less than \$250,000.

The bill would become effective January 1, 2011.

BACKGROUND

The United States Customs Service (Customs), operating under the Department of Homeland Security, is the resource for duty declarations completed by travelers returning to the United States from foreign destinations and for imports to the United States. Each individual arriving into the United States must complete the declaration form for all goods acquired abroad, and declarations are also made for imports. The Board has the authority under Revenue and Taxation Code Section 7054 to audit the customs declarations that travelers or import brokers fill out for goods entering the United States.

From July 1, 1990 through June 30, 2007, Customs gave the Board access to Customs declarations filed at various ports of entry throughout California for goods purchased abroad and *personally hand-carried* by passengers into California ports of entry. After June 30, 2007, however, Customs modified the access to these duty declarations and only allowed access to the Board in those instances where the Board can first identify the name of the traveler and the date traveled. This somewhat complicated the Board's efforts in identifying unpaid use tax with respect to items coming into California and personally hand-carried. However, for goods *shipped* into California, the Board has been able to acquire data (since July 2005) from Customs regarding declarations by both travelers who ship goods from the foreign country or California residents who import goods from a foreign country with a California destination. The Board matches the Customs electronic records of California imports against the Board's registration records, and determines whether the California businesses and individuals identified have complied with the Sales and Use Tax Law. From fiscal year 2006 through 2008, the program generated over \$19 million, for fiscal year ending 2009, the program generated over \$14 million in tax, over \$1.8 million in interest, and over \$870,000 in penalties.

In order to give purchasers the opportunity to report their use tax obligations on their state income tax returns, and to match that data to the Customs declarations, the Board examines Customs data for the years prior to the current calendar year. For example, since the use tax on purchases made during calendar year 2009 should be reported either to the Board or on the state income tax return due April 15, 2010, the Board is not examining declarations for 2009. Instead, the Board is reviewing 2008 declarations and earlier years for potential use tax. Because payment of use tax due on those purchases

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.

is already late, when the Board provides notice to the California purchaser of the use tax liability, penalty and interest has already accrued.

The Board sets the annual due date of the tax based on the date of purchase. The due date is either January 31 of the year following the date of purchase if the purchase was made during the first six months of the year, or July 31 for purchases made during the last six months of the previous year. For example, if the purchase subject to use tax was made in February 2008, the Board would establish a January 31, 2009 due date. If a purchase was made in August 2008, the due date for the use tax would be July 31, 2009.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in order to provide some relief for California purchasers making purchases abroad who receive notice of a use tax liability, with penalty and interest added to the notice. These notices come as a surprise to many, and the author believes that the imposition of interest on a liability for which the taxpayer is unaware, is unfair. This bill would enable a taxpayer to request relief of the interest in those cases in which the taxpayer paid the use tax liability within 90 days of the Board's notice.
2. **The April 15, 2010 amendments** specify that the Board, *meeting as a public body*, may relieve a person from the interest under the terms of the bill, and also limit the interest relief to those persons whose gross receipts from business operations are less than \$250,000, or if the person has no business operations, whose gross adjusted income is less than \$250,000.
3. **Some authority to provide relief should be delegated to staff.** With a possible 1,400 requests for relief each year (see Revenue Estimate on the next page), a more efficient and cost effective program would be to allow the Board Members to delegate to the staff the authority to relieve interest when the amount recommended for relief is below a certain threshold, such as \$500.
4. **Use tax liability comes as a surprise to many.** In an effort to close California's use tax gap - estimated to be over \$1 billion annually - the Board has instituted various programs that encourage compliance with the use tax law. For example, during 2009, ABx4 18 was enacted to require every business not already registered with the Board that has at least \$100,000 in gross receipts from business operations to register with the Board and file an annual use tax return. The Board is currently in the process of registering over 180,000 businesses, and requiring those businesses to report their purchases subject to use tax for years 2007, 2008 and 2009. Penalty and interest charges have already accrued on the 2007 and 2008 purchases, and the law has no provision currently for relief of the interest. The liability for use tax has surprised many of these California purchasers. Should all California purchasers who are billed for use tax also be included within these provisions?
5. **Related legislation.** There are currently two other bills introduced this session that seek to relieve interest in specific situations. AB 2375 (Knight) would allow the Board itself, meeting as a public body, to relieve interest on a late payment of tax if the Board finds that the late payment was due to extraordinary circumstances, as defined. SB 1028 (Correa) would allow the Board to compute interest on a late payment for one day (rather than the entire month) when the payment is only one day late, and the taxpayer was relieved of the penalty due to reasonable cause and circumstances beyond the person's control.

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.

COST ESTIMATE

An estimate of the increase in administrative costs is pending. These costs would be attributable to the staff work associated with the increase in the number of taxpayers seeking relief of interest under this bill and preparing cases for Board hearings. An estimate of these costs is pending.

REVENUE ESTIMATE

For fiscal year ending 2009, the Board sent nearly 7,000 notices and returns to California purchasers who were identified through the Customs data as having made taxable purchases from foreign countries. In response, the Board received back over 5,600 returns with payments of over \$11 million in use tax, over \$1 million in interest, and over \$500,000 in penalty. We do not have information on the adjusted gross income of these persons, nor do we know whether the purchasers have gross receipts from business operations of \$250,000 or more.

Using an average interest payment of \$179 per return (\$1 million/5,600), and assuming half of these purchasers would not qualify for relief due to the income thresholds, and that half of those that would qualify, would actually request and be granted relief, a total state and local interest revenue loss could amount to about \$250,600 ($\$179 \times 2,800/2$), as follows:

General Fund (6% for 6 mos. 5% for 6 mos.)	\$162,153
Fiscal Recovery Fund (0.25%)	7,371
Local Public Safety Fund (0.50%)	14,741
Local Revenue Fund (0.50%)	14,741
Bradley-Burns Local Sales and Use Tax (1%)	29,482
District taxes (0.75%)	<u>22,112</u>
 Total	 <u>\$250,600</u>

Analysis prepared by:	Sheila T. Waters	445-6579	04/21/10
Contact:	Margaret S. Shedd	322-2376	
ls			2556-3sw.doc

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.