STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Amended:	**06/16/08**	Bill No:	**AB 3079**
Tax:	**Sales and Use Fuels**	Author:	**Assembly Revenue and Taxation Committee**
Related Bills:		Position:	**Support as Sponsor**

BILL SUMMARY

This Board of Equalization (Board)-sponsored bill would do the following:

1. Authorize the Department of Industrial Relations (DIR) to share information it collects as part of its normal investigative and enforcement efforts with the Board. (Labor Code Section 64.5.)
2. Reduce the period of time for which the Board may issue a determination from eight years to three years when unregistered in-state purchasers, as defined, voluntarily report to the Board purchases subject to use tax (Revenue and Taxation Code Section 6487.06.)
3. Delete the January 1, 2009 sunset date of the Managed Audit Program and thereby extend the program indefinitely (Revenue and Taxation Code Section 7076.5).
4. Redefine "train operator" for purposes of the Motor Vehicle Fuel Tax Law, and require a train operator transporting fuel products to obtain a license and file monthly information reports on fuel products entering, moving within, and departing the state. (The heading of Revenue and Taxation Code Article 3 (commencing with Chapter 4 of Part 2 of Division 2), and Sections 7342, 7470, 7652.8, 60135 and 60204.6.)

Summary of Amendments

The amendments to this bill since the previous analysis specify that the DIR is authorized to transmit to the Board information in its records that indicates a retail establishment is operating without a seller s permit.

ANALYSIS

Information Sharing
Labor Code Section 64.5

CURRENT LAW

Under the Information Practices Act, Section 1798.24 of the Civil Code provides that no agency may disclose any personal information in a manner that would link the information disclosed to the individual to whom it pertains unless the information is disclosed to, among others, another agency where the transfer is necessary for the transferee agency to perform its constitutional or statutory duties, and the use is compatible with a purpose for which the information was collected and the use or transfer is accounted for, as specified. Existing law does not specifically prohibit the DIR from releasing information in its records that would assist the Board in administration of its tax laws.

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.

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On the other hand, existing law generally prohibits the Board and any person having an administrative duty or any person who obtains access to information contained in, or derived from, records of the Board to make known in any manner whatever the business affairs, operations, or any other information pertaining to a taxpayer.

However, under existing law, the Governor may by general or special order, authorize examination by other state officers, by tax officers of another state, by the federal government, if a reciprocal arrangement exists, or by any other person of the records maintained by the Board. The law specifies that any information so obtained pursuant to the order of the Governor may not be made public except to the extent and in the manner that the order may authorize that it be made public.

PROPOSED LAW

This bill would add Section 64.5 to the Labor Code to provide that when requested by the Board, the DIR may permit any duly authorized representative of that agency to transmit information available in the DIR's records that indicates a retail establishment is operating without a seller's permit, as specified.

This provision would become operative on January 1, 2009.

BACKGROUND

In 1973, pursuant to a Governor's Order that continues to exist today, Governor Reagan authorized the Board to release information to the DIR pertaining to the Sales and Use Tax and Use Fuel Tax programs. Specifically, the Governor's Order authorized official representatives of the DIR to examine records maintained by the Board with regard to those programs for use in its compliance and enforcement efforts. However, the agreement authorizes the Board to furnish information to the DIR. The agreement does not authorize for reciprocal exchange of information between the Board and DIR, and the DIR is not specifically authorized to provide any information it collects to the Board.

One of the divisions of the DIR, the Division of labor Standards Enforcement (DLSE), is responsible for, among other things, the investigation and enforcement of labor statutes covering workers' compensation insurance coverage, child labor, cash pay, unlicensed contractors, Industrial Welfare Commission orders, as well as group claims involving minimum wage and overtime claims. The DLSE also handles criminal investigations involving these group claims, and also administers the licensing, registration, and certification of certain industries, including employers, transporters, and supervisors of minors making door-to-door sales and industrial homeworkers and garment manufacturers.

As part of its investigative and enforcement efforts, the DLSE collects information regarding whether a business entity has a seller's permit. Their applications and renewal forms also contain information about the business entity such as its business name, ownership information, type of business and/or projects, business and mailing addresses, and telephone numbers.

COMMENT

Purpose. The purpose of this bill is to authorize the DIR to share information with the Board that it collects in the course of its investigative and enforcement efforts regarding whether retailers are operating without a seller's permit. Access to this information would enhance the Board's compliance and enforcement efforts by increasing the Board's ability to, ensure business entities possess a valid seller's

permit, and aiding in the Board's annual audit selection process. A statutory change is being sought so as to confer specific authority for the DIR to release that information to the Board.

Use Tax – Voluntary Reporting
Revenue and Taxation Code Section 6487.06

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 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.

Under existing law, Section 6487 of the Sales and Use Tax Law provides that persons who fail to file a return and pay their tax obligations (whether sales tax or use tax) can be held liable for past tax obligations, together with interest and penalties, for up to eight prior years (except in the case of fraud which has no limitation period in which to assess past tax obligations).

PROPOSED LAW

This bill would add Section 6487.06 to the Sales and Use Tax Law to provide that a deficiency determination mailed to a qualifying purchaser shall be limited to the three-year period beginning after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

The bill would define a ''qualifying purchaser'' as a person that voluntarily files an Individual Use Tax Return for tangible personal property that is purchased from a retailer outside of this state for storage, use, or other consumption in this state, and that meets all of the following conditions:

(1) The purchaser resides or is located within this state and has not previously done any of the following:

(A) Registered with the Board.

(B) Filed an Individual Use Tax Return with the Board.

(C) Reported an amount on their Individual California Income Tax Return.

(2) The purchaser is not engaged in business in this state as a retailer, as defined in Section 6015.

(3) The purchaser has not been contacted by the Board regarding failure to report the use tax imposed by Section 6202.

(4) The Board has made a determination that the purchaser's failure to file an Individual Use Tax Return or to otherwise report, or pay the use tax was due to

reasonable cause and was not caused by reason of negligence, intentional disregard of the law, or by an intent to evade the taxes imposed by this part.

The bill would provide that if the Board makes a determination that the purchaser's failure to timely report or remit the taxes imposed by this part is due to reasonable cause or due to circumstances beyond the purchaser's control, the purchaser may be relieved of any penalties imposed.

The bill would exclude purchases of vehicles, vessels, or aircraft, as specified.

This provision would become operative on January 1, 2009.

BACKGROUND

In 2003, the Board sponsored Assembly Bill 1741 (Stats. 2003, Ch. 697, effective January 1, 2004), which authorized the Board to administer an in-state voluntary disclosure program for qualifying purchasers (similar to the provisions in this measure). The Board's intent in creating this voluntary disclosure program was to encourage individuals, as well as businesses that are not required to hold a seller's permit or a consumer use tax permit, to voluntarily report their use tax liabilities. In exchange, the number of years of past-due use tax liabilities for which they would be held responsible would be reduced from eight years to three.[1] Also, the program provided for a waiver of any penalties. This shortened "look back period" was patterned after Section 6487.05 which was added to the Revenue and Taxation Code in 1994 to provide for a voluntary disclosure program for unregistered *out-of-state retailers* who have nexus in California.

AB 1741 contained a two-year sunset date, and the Board supported a subsequent measure - AB 671 (Stats. 2005, Ch. 308) - to extend this provision for an additional two years. Section 6487.06, however, sunsetted on December 31, 2007.

COMMENTS

Purpose. This provision is intended to reinstate this voluntary disclosure program for qualifying purchasers indefinitely. Since its inception, this program has proven to be successful in giving taxpayers an incentive to come forward and report their past use tax obligations.

Since its inception, the program has had the following results:

- 1/1/07 through 8/31/07 – 15 taxpayer voluntarily registered and reported $1.6 million.
- 2006 - 29 taxpayer voluntarily registered and reported $3.9 million
- 2005 - 266 taxpayers voluntarily registered and reported $15.2 million (California's amnesty program resulting in the dramatic increase).
- 2004 - 139 taxpayers voluntarily registered and reported $3.7 million

Reinstating this exemption is particularly important now, as the Governor's proposed 2008/09 budget includes funding for the Board to, among other things, concentrate on businesses that purchase goods without paying applicable use taxes. As the Board implements this program and awareness of this effort

[1] Purchases of vehicles, vessels and aircraft, however, are excluded from the shortened "look-back" provisions.

increases, we anticipate more service enterprises will voluntarily come forward with the incentive of a shortened look back period.

Managed Audit Program
Revenue and Taxation Code Section 7076.5

CURRENT LAW

Under existing law until January 1, 2009, the Board is authorized to utilize a Managed Audit Program (MAP) in which taxpayers can perform an audit of their own books and records, with limited guidance from the Board, in order to determine tax deficiencies. As an added incentive to participate in the program, interest on a tax liability disclosed as a result of an approved MAP audit is computed at one-half the normal statutory interest rate for the total unreported tax liability. In return for performing the managed audit, the taxpayer is liable for only one-half of the interest usually imposed under current law (currently, the rate of interest for underpayments of tax in general is 11%, and taxpayers performing managed audits receive a reduced rate of 5.5% on tax deficiencies identified in that audit).

Managed audits are essentially self-audits. The Board is authorized to determine which taxpayer accounts are eligible to participate in a MAP and to enter into MAP participation agreements with eligible taxpayers. If the taxpayer is eligible, the auditor provides the taxpayer with written and oral instructions to enable the taxpayer to perform the audit verification and prepare the working paper schedules necessary to complete a particular portion of the audit. Taxpayers who meet the following criteria are considered candidates for a managed audit:

- Taxpayers whose businesses involve few or no statutory exemptions;
- Taxpayers whose businesses involve a single or small number of clearly defined taxability issues;
- Taxpayers who agree to participate in the MAP; and
- Taxpayers who have the resources to comply with the managed audit instructions provided by the Board.

PROPOSED LAW

This bill would repeal Section 7076.5 of the Revenue and Taxation Code to delete the January 1, 2009 sunset date and thereby extend the managed audit program indefinitely.

BACKGROUND

The original MAP was added by Board-sponsored SB 1104 (Ch. 686, Stats. 1997, effective January 1, 1998) and contained a sunset provision of January 1, 2001. In 2000, the Board sponsored legislation (AB 2898, Ch. 1052) to extend the sunset date of the MAP by two years, to January 1, 2003. AB 1043 (Ch. 87, Stats. 2003, effective January 1, 2004) reauthorized the Board to utilize the MAP until January 1, 2009.

AB 1043 also required the Board, on or before January 1, 2008, to submit a report to the Legislature regarding the MAP as of June 30, 2007. The analysis of the MAP for a 39-month period (April 1, 2004 through June 30, 2007) showed the following:

Total MAP audits completed		97
Total revenue derived from MAP audits (taxes, penalties, and interest)	$	13,212,310
Total amount of interest forgiven	$	1,442,095
Estimated number of audit hours saved		4,695
Estimated additional audit liability from redirecting audit resources (taxes, penalties, and interest)	$	2,286,465[2]
Net revenue gain	$	844,370[3]

COMMENT

Purpose. This provision is intended to extend the MAP indefinitely, as the program has proven to be advantageous for both taxpayers and the Board in a number of ways, such as:

- The program provides resolution to questions about the taxability of transactions during the audit process, thus reducing the number of audits requiring resolution through the administrative appeals process.
- The program provides for a more efficient allocation of audit resources to audits and other revenue-generating activities.
- The program reduces litigation related to protested audits.
- A managed audit decreases disruption of a taxpayer's regular business activities since an auditor is likely to spend fewer hours at the taxpayer's place of business.
- The program promotes an ongoing cooperative relationship between the taxpayer and the Board.
- The program provides the taxpayer with a better understanding about the application of sales and use tax to transactions related to his or her business.

Train Operator Monthly Information Reports

Revenue and Taxation Code Article 3 (commencing with Chapter 4 of Part 2 of Division 2), and Sections 7342, 7470, 7652.8, 60135 and 60204.6

CURRENT LAW

Under the Motor Vehicle Fuel Tax Law (Part 2 (commencing with section 7301) of Division 2 of the Revenue and Taxation Code, the state imposes an excise tax of $0.18 per gallon on the removal of motor vehicle fuel (gasoline) at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person.

Similarly, under the existing Diesel Fuel Tax Law (Part 31 (commencing with Section 60001) of Division 2 of the Revenue and Taxation Code, the state also imposes an excise tax of $0.18 per gallon on the removal of diesel fuel at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person, unless specifically exempted.

[2] $2,286,465 [4,695 (audit hours saved) x $487 (average dollar per audit hour return at the statewide rate)]
[3] $844,370 [$2,286,465 - $1,442,095 (amount of interest forgiven)]

In general, California's reporting scheme for these fuel taxes is based on the premise that all fuel products must be accounted for within the bulk transfer/terminal system in California, which consists of refineries, pipelines, vessels, and petroleum terminals. The reporting system presently includes information reports provided by vessel and pipeline operators (the carriers), receipt and disbursement reports filed by terminal operators, and tax returns recounting terminal removals and taxable imports filed by licensed suppliers. The reporting system allows for the cross-checking of transactions between carriers and terminals and between terminals and suppliers. This information is used by the Board for audit and compliance purposes to ensure the fuel gallons and taxes are properly reported and collected.

As part of this effort, Section 7403.1 of the Motor Vehicle Fuel Tax Law and Section 60106.1 of the Diesel Fuel Tax Law provide that train operators are required to obtain a license or permit from the Board for the purpose of issuing exemption certificates to their suppliers for the fuel used in operating trains (fuel used "off-highway" is generally exempt from the state fuel taxes). Sections 7403.2 and 60107, respectively, require such train operators to provide information reports to the Board on the gallons of fuel purchased *for use* in their trains, or for other off-highway use, under an exemption certificate.

Currently, Sections 7652.7 and 60204.5 provide that only vessel and pipeline operators are required to file reports with the Board regarding motor vehicle fuel (gasoline) and diesel fuel carried by their vessels and pipelines, as these fuel movements are deemed "above the rack," i.e., before the point of taxation. Existing law does not require train operators who transport fuel by rail to file such reports.

PROPOSED LAW

This bill would amend the heading of Article 3 (commencing with Section 7470) of Chapter 4 of Part 2 of Division 2 of the Revenue and Taxation Code, and amend Sections 7342, 7470, and 60135, of, and add Sections 7652.8 and 60204.6 to, the Revenue and Taxation Code, to do the following:

1. For purposes of the Motor Vehicle Fuel Tax Law, expand the definition of "train operator" to include a person that owns, operates, or controls *any* train (not just motor vehicle fuel-powered trains) that is licensed as a railroad by a state or federal agency.
2. For purposes of the Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law, require every train operator that transports specified fuel into, out of, or within this state to obtain a license from the Board, and
3. Require each train operator to prepare and file with the Board a report, as specified, which must include specified information regarding the amount of, location of, and date of delivery of, specified fuel and any other information required by the Board for proper administration of the Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law.

These provisions would become operative January 1, 2009.

BACKGROUND

In 1995 and in 2002, the imposition of the diesel fuel and motor vehicle fuel taxes, respectively, was moved to the "rack" (the "rack" is a mechanism for delivering fuel from a refinery or terminal into a truck, trailer, railroad car, or similar means). At that time, very little fuel moved by rail in California, and almost all of that movement

related to fuel destined for export to neighboring states. Therefore, train operators have not been required to report movements of fuel by rail, because such movements occurred *after* the point of taxation.

However, since that time, many significant changes have occurred in the California petroleum market. First, California gasoline was reformulated to use ethanol as an oxygenate (the ethanol is added to fuels, especially gasoline, to make them burn more efficiently). Because of its properties, ethanol, which is primarily produced in the Midwest, cannot be shipped by pipeline (due to its corrosive qualities and the possibility that water in the pipeline might damage the fuel). Therefore, millions of gallons of ethanol are being shipped into the state each year, primarily by rail. Second, the California Legislature and the Governor have made the reduction of greenhouse gas emissions a priority with the signing in 2006 of both AB 32 (Ch. 488, Stats. 2006, The California Global Warming Solutions Act) and Executive Order S-01-07, which directed the establishment of a low carbon fuel standard for transportation fuels used in California. Additionally, biodiesel fuels continue to be popular alternatives to petroleum diesel fuel. Like ethanol, these fuel stocks are primarily produced in the Midwest and shipped by rail into California.

Board staff is concerned about the lack of accountability for rail imports since rail movements are not currently considered part of the bulk transfer system. Ethanol is a reportable product for motor fuels reporting, meaning that it is not a taxable product itself but becomes taxable when blended with motor vehicle fuel to produce California Reformulated Gasoline. This blending must occur within the petroleum terminal, and terminal operators report their receipt of ethanol into the terminals. But without reports from the rail carriers, the Board has no way of cross-checking to determine if all of the ethanol delivered by the rail carriers from out-of-state locations to in-state terminals is actually being reported by the in-state petroleum terminal operators. During 2006, California petroleum terminals reported receiving 1.2 billion gallons of ethanol.

Unlike ethanol, biodiesel and similar biofuels are considered taxable fuel products and are subject to tax when imported into the state. Additionally, biofuel imports generally bypass the terminal system and are delivered directly to distributors or end-users. Biofuel importers are required to be licensed as suppliers and remit tax on the fuel imported into the state. The Board makes every effort to identify and timely register biofuel importers but continues to come across taxpayers who are operating without the proper license and incurring unreported tax liabilities because they are importing biofuels by rail. Rail carrier reporting would assist in more timely identification of unlicensed biofuel importers and lead to a greater level of voluntary compliance and tax recovery. During 2006, 20.8 million gallons of biodiesel fuel were reported as having been received from out-of-state sources. In addition, using alternative means of identifying biodiesel importers who have not reported their biodiesel imports, the Board is investigating several audit leads with a potential for $360,000 in additional tax assessments.

COMMENT

Purpose. This bill is intended to address the lack of accountability for rail imports since rail movements are not currently accounted for under the existing bulk transfer system. We anticipate that California would realize a direct tax benefit from rail carrier reporting because these reports would provide valuable information to the Board that can be used in improving motor fuel tax collection and enforcement efforts. The

Board is aware of at least eight states that require rail carriers to report fuel movements into and out of their states, and we are unaware of any concerns voiced by these carriers over these added reporting requirements.

COST ESTIMATE

The provision in the bill that would require that the DIR provide the Board with information, and the provisions relating to train operators and ethanol fuel, would not significantly affect the Board's administrative costs. However, the Board would incur some costs related to the provision in the bill that would reinstate the use tax voluntary disclosure program.

With a voluntary disclosure program permanently in place, and a growing population of qualified purchasers, one additional tax specialist position would enable the Board to conduct the program in an efficient manner and not impede upon other revenue enhancing projects pursued by the Board. These costs are estimated to be $90,000 annually.

REVENUE ESTIMATE

The provision in the bill that would require that the DIR provide the Board with seller's permit information, and the provisions relating to train operators and ethanol fuel, would improve and facilitate the Board's administration of the Sales and Use Tax Law, the Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law, and to that extent, could have a positive effect on the state's revenues of an unknown amount.

With respect to the use tax voluntary disclosure provisions, based on past experience we expect these provisions would generate an additional $2.5 million annually, and with the MAP provision, we expect an increase of $260,000, as follows:

	Voluntary Disclosure	MAP	Total
State General Fund (5%)	$1,574,307	163,728	$1,738,035
State Fiscal Recovery Fund (1/4%)	78,715	8,186	86,901
Local Revenue Fund (1/2%)	157,431	16,373	173,804
Local Public Safety Fund (1/2%)	157,431	16,373	173,804
Local and County (1%)	314,861	32,746	347,607
Special districts (.69%)	217,255	22,594	239,849
Total	$2,500,000	260,000	$2,760,000

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