



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	06/16/10	Bill No:	<a href="#">SB 884</a>
Tax:	Sales and Use	Author:	Ashburn & Runner
Related Bills:	SB 1110 (Runner)		

### BILL SUMMARY

This bill would make several changes related to the use tax registration program enacted by last year's ABx4 18. It would:

- Specify that, for reporting periods on or after January 1, 2010, Article 1 (commencing with Section 6451) of Chapter 5 of the Sales and Use Tax Law shall apply.
- Authorize the Board to grant a reasonable extension of time for filing 2009 returns pursuant to this program up to six months, as specified.
- Waive all penalties for reporting periods 2007, 2008 and 2009 provided that the qualified purchaser pays all use tax liability for those periods by March 15, 2011, and require the Board to make refunds of any penalties paid for the 2007, 2008 and 2009 reporting periods, as specified.

### SUMMARY OF AMENDMENTS

The amendments to this bill since our previous analysis delete the provisions that would have aligned the return due dates with the income tax filing due dates, and instead, specify that for reporting periods on or after January 1, 2010, Article 1 (commencing with Section 6451) of Chapter 5 shall apply. The amendments would also authorize the Board to grant an extension up to six months for only the 2009 reporting period, as specified.

### 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. 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.

Revenue and Taxation Code Section 6225 was added by ABx4 18 (Ch. 16, Stats. 2009) to require "qualified purchasers" to register with the Board and report and pay by April 15, the use tax owed for purchases made during the preceding calendar year. While this section does not impose a penalty for a person's failure to timely register, existing law pursuant to Revenue and Taxation Code Section 6591 provides

---

*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.*

for the imposition of a 10% penalty on any amount of tax, plus interest - currently at a rate of 7% annually - not timely remitted to the Board.

A “qualified purchaser” is defined in Section 6225 as a person that is not required to hold a seller’s permit or not already otherwise registered or required to register with the Board, and that receives at least \$100,000 in gross receipts from business operations per calendar year (such as accountants, dental offices, law firms, real estate firms, etc.).

Under existing law, the Board has the general authority pursuant to Revenue and Taxation Code Section 6459 to extend for up to one month for good cause the time for making any return or payment, provided a request for the extension is filed with the Board within or prior to the period for which the extension may be granted. Persons to whom an extension is granted may be relieved of the 10% late payment penalty for that 30 day period, but are required to pay interest on any unpaid tax from the date the tax was due until the last day of the month in which the payment is made (currently at a rate of 7% annually).

Existing law also authorizes the Board pursuant to Revenue and Taxation Code Section 6592 to relieve a person of the late payment penalty, when it finds that a person’s failure to make a timely return or payment is due to reasonable cause and circumstances beyond the person’s control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. To be relieved of the penalty, Section 6592 requires that a request for relief be filed with the Board.

Article 1 (commencing with Section 6451) of Chapter 5 of the Sales and Use Tax Law, specifies the due dates of sales and use taxes imposed and returns that are required to be filed. Generally, returns and payments are due quarterly on or before the last day of the month following the quarterly period. Section 6455 of this article, however, specifies that if the Board deems it necessary in order to ensure payment or to facilitate collection by the State of sales or use taxes, the Board may require returns and payment of taxes for other periods. Pursuant to Section 6455, the Board has placed about half of all sales and use tax taxpayers on an annual basis – some on an annual calendar basis, and others on the state’s fiscal year basis – due to the small amount of sales and use tax liability the taxpayer incurs. All returns and payments are due to the Board pursuant to this article at the end of the month following the reporting period. For example, for taxpayers on an annual calendar year basis, the return and payment is due no later than January 31 of the following year; for taxpayers on the state’s fiscal year annual basis (July 1 to June 30), the return and payment is due no later than July 31 of that fiscal year.

#### **PROPOSED LAW**

This bill would amend Sections 6225, 6459, and 6592 of, and add Sections 6225.1 and 6225.2 to, the Revenue and Taxation Code to do the following:

- Specify that for reporting periods on and after January 1, 2010, Article 1 (commencing with Section 6451) of Chapter 5 shall apply to a qualified purchaser. (*Section 6225*)
- Specify that returns for the 2009 reporting period only, for purposes of administering the use tax registration program, the Board may grant a reasonable extension of time for filing the return, and, except for taxpayers residing or traveling abroad, an extension of time shall not be granted for more than six months. For those residing or traveling abroad, a return shall be filed

---

*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.*

no later than the 15<sup>th</sup> day of the sixth month following the close of the taxable year, unless the requirements for an extension have been fulfilled on or before that date. (*Section 6225.1*)

- Specify that the extension of time granted is not an extension of time to pay, and that penalties and interest shall be imposed as provided by law without regard to any extension granted. (*Section 6225.1*)
- Specify that a penalty shall not be imposed on a qualified purchaser's failure to timely remit use tax for reporting periods in 2007, 2008, and 2009, except as specified, and any penalty paid for those periods shall be refunded by the Board. (*Section 6225.2*)
- Specify Legislative findings and declarations that this act and its retroactive application are necessary to serve a public purpose by ensuring the fair and equitable treatment of taxpayers. (*Section 6*)

The bill is an urgency measure, and as such, would take effect immediately.

### **BACKGROUND**

In 1933, California enacted its first retail sales tax. Within a few years of the adoption of the sales tax, California retailers believed they were facing unfavorable competition from retailers in states that had not adopted a sales tax. Customers could choose to go to a neighboring state without a sales tax and avoid paying the tax on their purchases. California responded to this challenge in 1935 by adopting a use tax. The use tax is virtually identical to the sales tax, except it is imposed on the storage, use or consumption of the goods; and the tax is imposed on the sales price of the good. The intent of a use tax is to offset the incentive to purchase from retailers in other states with low sales tax rates or no sales tax.

Although every state that has a sales tax imposes the use tax, there has been limited success in collecting the use tax from individual purchasers. Unlike the retail sales tax that requires in-state retailers to pay the tax, states have been unable to impose a similar compliance and collection requirement on out-of-state retailers (an out-of-state retailer must have physical presence in a state in order to require that retailer to collect the use tax).

Therefore, California must rely on purchasers to report their use tax obligations on their out-of-state purchases, such as those made over the Internet or through mail order. And, even though a separate line is currently on the state income tax return with accompanying instructions in the booklet for a simple, convenient way to report use tax, the compliance rate has been low. Unreported use tax is the largest area of noncompliance in California's sales and use tax program - an estimated \$1.1 billion annually is attributable to unreported California use tax by both businesses and individual consumers. For 2009, the Franchise Tax Board (FTB) processed over 18.2 million returns, yet only 50,540 state income tax returns had use tax reported yielding only \$10 million in state and local use tax revenues. Individuals report a much greater proportion of the tax than businesses (in 2009, for example, businesses only reported \$1.7 million of the total \$10 million).

ABx4 18 was a budget revision measure signed into law on July 28, 2009. This measure was enacted in an effort to minimize this competitive advantage many out-of-state retailers have over in-state retailers, and to increase the collection of use

taxes owed by the larger California businesses that do not make sales of tangible personal property, but that may be incurring a use tax liability.

More than 198,000 taxpayers have been registered by the Board pursuant to these provisions and have been notified to report and pay their use tax liability for purchases subject to use tax for the 2009 calendar year by April 15, 2010. Additionally, the Board is also requiring that these taxpayers file use tax returns for calendar years 2007 and 2008 for their untaxed purchases.

Beginning in September 2009, the Board sent these taxpayers an initial notification letter informing them of the new law. The letters further explained that the Board is creating an account for recipients so that they can report and pay their use tax liabilities online. Although returns and payments may all be done online, the registration form (a simple one-page form) must be mailed, as well as any requests for relief of penalty.

As of June 14, 2010, the Board has received over 245,000 returns by nearly 88,000 qualified purchasers, with payments totaling over \$25 million. Of that amount, penalty revenue of \$991,144 has been collected.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. Its purpose is to allow businesses an automatic extension of the filing due date for their 2009 returns, and provide automatic forgiveness of penalties for the 2007, 2008, and 2009 reporting periods, as many taxpayers were not notified nor are aware of the use tax registration requirement.
2. **Automatic penalty relief would simplify things.** Under current law, persons seeking relief of any late payment penalty imposed under the Sales and Use Tax Law (including the late payment penalty attributable to a qualified purchaser's late payment of a use tax liability) must file a request for relief. Each such request is reviewed by staff and granted or denied on a case-by-case basis. This bill would eliminate the need for qualified purchaser to file a request, and would instead, allow the Board to unilaterally provide automatic relief of the late payment penalty for all qualified purchasers. This would eliminate the staff time attributable to reviewing each request for relief filed (to date, about 942 requests for relief of penalty have been filed under this program).
3. **Referencing Article 1 of Chapter 5 would enable the Board to place this group of taxpayers on an annual reporting basis consistent with the majority of other sales and use tax taxpayers.** By eliminating the April 15 due date, and referencing this article in the Sales and Use Tax Law, the Board would have authority to establish calendar year or fiscal year reporting bases for these qualified purchasers – as the Board currently has for most sales and use tax taxpayers. Accordingly, the returns and due dates of the tax would either be on January 31 following the calendar year for those taxpayers the Board designates to be on a calendar year reporting basis, or July 31 for those taxpayers the Board designates to be on a fiscal year (July 1 to June 30) basis.
4. **Is automatic relief for 2007, 2008 and 2009 necessary?** At its March, 24, 2010 Board Meeting, Members of the Board heard from the taxpayer community that the April 15, 2010 deadline for filing is creating hardship for many businesses. The Members directed Board staff to make it clear to taxpayers that they may request relief from penalty or request a 30-day extension. In response, staff has placed

*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.*

forms for both requests on the home page of the Board's website and other locations convenient for the taxpayer. To ease the burden on taxpayers, the staff is allowing taxpayers to submit one form to request relief of penalty for 2007, 2008 and 2009 returns, and staff indicated that it would be open to relieving taxpayers from the penalty, when there is reasonable cause related to the late filing. This would essentially buy taxpayers the additional time they may need to file their returns without incurring a penalty.

Proponents note, however, that many qualified purchasers that have voluntarily complied with these new provisions and who have filed returns for the past three years and paid the 10 percent penalty, have not requested relief of the penalty (maybe mistakenly believing that their lack of knowledge of the use tax law would not be a basis for excusing them from the penalty). Even though it is likely that staff would have granted relief due to the nature of this program, if a qualified purchaser fails to file the request, no relief is granted. Proponents see this as unfair and inconsistent. The automatic relief provisions in SB 884 would give the Board the authority to excuse all qualified purchasers from the imposition of the penalty – not just those that ask for relief.

5. **Should all “qualified purchasers” be automatically relieved of the penalty for all three years even if they have had prior contact with the Board?** In recent years, the Board has stepped up its outreach efforts regarding purchasers' use tax liabilities through broad educational efforts aimed at a wide audience as well as more specifically targeted groups, such as the tax preparer community. For example, in early 2008, the Board sent information about use tax reporting on state income tax returns to 71,000 tax professionals in order to encourage them to consider their clients' use tax liability when preparing their year-end tax returns. The mail list included certified public accountants, enrolled agents, and members of the California Tax Education Council. Since many tax preparers would be considered “qualified purchasers” under this use tax registration program, is it equitable to relieve them - or any other purchaser with whom the Board has had prior direct contact regarding use tax - of the penalty for all three years when they have received use tax information directly from the Board?
6. **This bill would provide automatic extensions and penalty relief for this group of purchasers, but no one else.** 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, before enactment of ABx4 18, the Board instituted a statewide compliance outreach effort. This effort is ongoing, and the Board continually identifies purchasers (outside the scope of ABx4 18) that are liable for the use tax. When these purchasers are identified, the Board requires these purchasers to report their use tax obligations for the past three years. Penalty and interest charges are also imposed on the late payment of use tax identified under this program (although purchasers may request relief of the penalty, as they can under the ABx4 18 provision). The liability for use tax has surprised many of these California purchasers. Is it fair to automatically waive all penalties for one group of taxpayers and not others?
7. **Related legislation.** SB 1110 (Runner) would also make changes to the use tax registration program.

**COST ESTIMATE**

Although the staff time associated with reviewing and processing requests for relief of penalty would be eliminated with enactment of this bill, other costs would be incurred in the processing of refunds for payments of the penalty for returns filed late for the 2007, 2008 and 2009 reporting periods, revising publications and updating the Board's website. The net costs would appear to be absorbable.

**REVENUE ESTIMATE**

This bill would provide qualified purchasers with an additional 11 months to file and pay their use tax liabilities for 2007, 2008 and 2009, and would require the Board to make refunds of any penalty paid on use tax liabilities remitted during that time. To the extent some taxpayers delay remitting their use tax until March 15, 2011, some shifting of revenues from fiscal year 2009-10 to 2010-11 could occur. There could also be some foregone penalty revenue attributable to those taxpayers that voluntarily remitted the penalty and did not request relief (under current law, unless a taxpayer requests relief of the penalty, no relief is granted). The amount of shifting is indeterminable at this time. However, the amount of foregone state and local penalty revenue which the Board would be required to refund pursuant to this measure would amount to \$991,144 as of June 14, 2010.

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	06/17/10
Contact:	Margaret S. Shedd	(916) 322-2376	
ls			0884-2sw.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.*