



*California State Board of Equalization,
Legislative Division*

LEGISLATIVE BULLETIN



State Capitol Building (from the East) c.1945
Photo courtesy of California State Archives

SALES TAX LEGISLATION

2004

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Assembly Bill 1416 (Bermudez) Chapter 412
Tax Practitioner – Client Confidentiality

Effective January 1, 2005. Among its provisions, amends Section 7099.1 of the Revenue and Taxation Code.

BILL SUMMARY

This bill extends the sunset date on the tax practitioner-client confidentiality privilege from January 1, 2005 to January 1, 2009.

**Sponsor: California Society of Certified Public Accountants
California Society of Enrolled Agents**

LAW PRIOR TO AMENDMENT

Under current law, confidential communications between a client and an attorney are protected from disclosure to third parties, under certain circumstances (Evidence Code Sections 950 – 962). Under the Internal Revenue Service Restructuring and Reform Act of 1998, the attorney-client privilege is extended to tax advice, as defined, that is furnished to a client-taxpayer by any individual who is authorized to practice before the IRS as well as any federal court, if the IRS is a party to the proceeding.

Current Sales and Use Tax Law conforms to the federal provisions by extending similar tax practitioner-client confidentiality privileges. California law provides that with respect to tax advice, certain protections of confidentiality that apply to a communication between a client and an attorney shall also apply to a communication between a taxpayer and any federally-authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a client and an attorney. The term "federally authorized tax practitioner" means any individual who is authorized under federal law to practice before the IRS if the practice is subject to regulation. These individuals include attorneys, CPA's, enrolled agents, and enrolled actuaries who are required to abide by the Standards of Ethical Conduct as published in U.S. Treasury Department Circular 230. "Tax advice" is defined as advice given by an individual with respect to a matter that is within the scope of the individual's authority to practice. The confidentiality protection only applies to the extent that the communication would be considered a privileged communication if it were between a client and an attorney, and only in non-criminal tax matters before the specified state agencies. The privilege does not apply to any written communication between a federally-authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or

indirect participation of that corporation in any tax shelter, or in any proceeding to revoke or otherwise discipline any license or right to practice by any governmental agency. These provisions will be repealed as of January 1, 2005 unless another statute is enacted that extends that date.

AMENDMENT

Among its provisions, this bill amends Section 7099.1 of the Sales and Use Tax Law to extend the sunset date on the tax practitioner-client confidentiality privilege from January 1, 2005 to January 1, 2009.

BACKGROUND

The attorney-client privilege extends to the client the privilege to refuse to disclose and to prevent any other person from disclosing confidential communications between the client and his/her attorney. Such privilege protects communications between the attorney and client made for purposes of furnishing or obtaining professional legal advice or assistance. The privilege also permits an attorney to refuse to testify as to communications from the client.

Assembly Bill 1016 (Ch. 438, Stats. 2000), added the tax practitioner-client privilege to current law. That bill contained a sunset date of January 1, 2005.

COMMENTS

1. **Purpose.** The purpose of this bill is to extend the sunset date for the tax practitioner-client privileges that mirror the IRS Restructuring and Reform Act with respect to confidentiality privileges.
2. **Key amendments.** Previous versions of this bill contained provisions relating to taxation of cigarette and tobacco products. The **June 17, 2004 amendments** removed those provisions and replaced them with the provisions to extend the sunset date on the tax practitioner-client confidentiality privilege.
3. **Allowance of these privileges to Board matters could preclude the discovery and use of any correspondence from a federally-authorized tax practitioner to the taxpayer.** If the privilege also applies or is expanded to court proceedings, it would be much more difficult to prove fraud if the taxpayer files suit in superior court. There has been at least one instance where, prior to the passage of AB 1016, a taxpayer could have successfully prevented the Board from viewing a letter at a Board hearing, which may have precluded the imposition of fraud and failure to file penalties. However, since these provisions have been in effect, there has not been an adverse impact on Board proceedings.

Assembly Bill 2115 (Committee on Budget) Chapter 610

Budget Trailer Bill – Triple Flip

Effective September 20, 2004. Among its provisions, amends Section 7203.1 of the Revenue and Taxation Code.

BILL SUMMARY

This bill makes technical corrections and clarifying changes to SB 1096 (Committee on Budget and Fiscal Review, Chapter 211, Statutes of 2004), the local government Budget trailer bill. Among its provisions, this bill provides that, during the revenue exchange period (also known as the “Triple Flip”) the applicable local sales and use tax rate in the case of a county is 1 percent, and in the case of a city is 0.75 percent or less (this change replaces the language that required a county or a city to impose a sales and use tax at a rate as specified in the local ordinance as of January 1, 2004, reduced by 0.25 percent). The provisions of this bill take effect immediately.

Although this bill affects property tax, sales and use tax, and vehicle license fee revenues, this analysis discusses the sales and use tax provisions only. The property tax and vehicle license fee provisions are not discussed because they are not within the scope of administration by the Board.

Sponsor: Assembly Budget Committee

LAW PRIOR TO AMENDMENT

The Sales and Use Taxes Law (commencing with Section 6001 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

The statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. However, beginning July 1, 2004, the state tax rate increased by 0.25 percent, from 6 to 6.25 percent, and the local tax rate decreased by 0.25 percent, from 1.25 to 1 percent. The revenues from the 0.25 percent state tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent is allocated to the state’s General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);

- 0.25 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city to impose a local sales and use tax rate of 1 percent that is credited against the county rate. Beginning on July 1, 2004, and continuing through the revenue exchange period, existing law temporarily suspends the authority of a county or a city to impose a tax under the Bradley-Burns Law, and instead provides that the applicable rate is the rate that was specified in the local ordinance as of January 1, 2004, reduced by 0.25 percent.

Existing law also provides that this reduction in the local tax rate will be increased by 0.25 percent when the DOF has made a specified notification to the Board, pursuant to Section 99006 of the Government Code, that the \$15 billion Economic Recovery bond has been repaid.

AMENDMENT

This bill makes technical amendments to the Triple Flip as made by SB 1096 (Committee on Budget and Fiscal Review, Chapter 211, Statutes of 2004), a local government budget trailer bill. SB 1096 enacted statutory changes related to the local government portion of the 2004-05 Budget Act, and also made technical amendments to the Triple Flip. This bill makes additional technical amendments to the Triple Flip. Among other things, this bill amends Section 7203.1 of the Revenue and Taxation Code to provide that, during the revenue exchange period, the applicable local sales and use tax rate is: (1) in the case of a county, 1 percent; and (2) in the case of a city, 0.75 percent or less.

This bill provides legislative findings and declarations that the provisions of this bill are in its entirety an "interim measure" within the meaning of Proposition 65. If Proposition 65, The Local Taxpayers and Public Safety Protection Act, on the November 2, 2004 general election ballot, is approved by the voters, the bill states that its effect and operation will be suspended pending approval of such interim measure by the voters at the first statewide election occurring after the passage of Proposition 65.

The provisions of this bill became effective September 20, 2004.

BACKGROUND

The original "Triple Flip" bills, Assembly Bill 7x (Chapter 13 of the First Extraordinary Session, Oropeza) and Assembly Bill 1766 (Chapter 162, Committee on Budget)

were signed by Governor Davis on August 2, 2003, as part of the 2003-04 Budget Plan. AB 7x enacted the California Fiscal Recovery Financing Act and authorized the issuance of \$10.7 billion in bonds to finance the cumulative 2002-03 budget deficit. AB 7x would have increased the state tax rate by 0.50 percent but would have decreased the local tax rate by 0.50 percent (cities and counties would be reimbursed for their local tax revenue losses through property tax revenues). The revenues from the 0.50 percent state sales and use tax increase would be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit-financing bonds.

AB 1766 implemented the property tax component of the "Triple Flip." Under AB 1766, cities and counties are reimbursed for the 0.50 percent reduction in the local sales and use tax rate (in AB 7x) through property tax revenues. Property tax revenues otherwise allocated to the ERAF would be diverted to the Sales and Use Tax Compensation Fund (SUTCF) established in each county. The state, in turn, would make schools whole with increased General Fund support, as required under Proposition 98. The provisions of AB 7x and AB 1766 were to become operative on July 1, 2004.

On December 12, 2003, Governor Schwarzenegger signed Assembly Bill 9 (Chapter 2 of the Fifth Extraordinary Session, Oropeza), which reduced the amounts proposed under the original "Triple Flip" bills (AB 7x and AB 1766). AB 9 enacted the Economic Recovery Bond Act and authorized the issuance of up to \$15 billion of bonds to finance the accumulated budget deficit. The voters approved Governor Schwarzenegger's \$15 billion bond measure (Proposition 57) on March 2, 2004. AB 9 became operative July 1, 2004.

AB 9, among other things, reduces the increase in the state portion of the sales and use tax rate, from 0.50 percent to 0.25 percent (dedicated to the repayment of the deficit bonds), and decreases the related reduction in the local sales and use tax rate from 0.50 percent to 0.25 percent (local governments will be reimbursed for their local tax revenue losses with increased property tax revenues). This bill requires that the revenues from the 0.25 percent state sales and use tax rate increase be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

As previously stated, the provisions of AB 9 provide that cities and counties will be reimbursed for the reduction in the local sales and use tax revenues through property tax revenues from the ERAF. The DOF, in conjunction with Board staff, will prepare an annual estimate by September 1 of each fiscal year of the local sales and use tax revenue losses attributable to the reduction in the local sales and use tax rate. This estimate is based on prior year distributions of local sales and use tax revenues. Cities and counties will receive the property tax replacement revenues twice a year—in January and May. At the end of each fiscal year, the property tax replacement revenues will be adjusted to reconcile with the actual amount of local sales and use tax revenues *not* transmitted as a result of the 0.25 percent reduction in the local sales and use tax rate.

COMMENTS

1. **Purpose.** The purpose of this bill is to make technical corrections and clarifying changes to the Triple Flip as made by SB 1096 (Senate Budget and Fiscal Review Committee, Chapter 211, Statutes 2004), the local government finance Budget trailer bill. According to staff from Assembly Budget Committee, after the enactment of SB 1096, a number of errors, omissions, and necessary revisions were identified. This cleanup bill addresses various technical issues raised by local governments, the State Controller's Office, the Board of Equalization, and Legislative staff.
2. **Key amendments.** The **August 23, 2004 amendments** make the technical corrections detailed previously. The previous version of this bill was related to education finance and was outside the purview of the Board.
3. **This bill amends subdivision (a) of Section 7203.1 to address those cities with ordinances imposing less than the full 1 percent rate or that have scheduled rate changes.** Section 7203.1, added by AB 9 (Committee on Budget, Chapter 2, Statutes of 2003), set the rate at 1 percent for a county and set the rate at 0.75 percent for a city. By setting the rate at a fixed amount, cities were prohibited from imposing a rate of less than 0.75 percent, thus defaulting the balance of the 0.75 percent rate to the county in which the city is located.

SB 1096 amended Section 7203.1 (a) to address those cities that imposed a rate of less than 1 percent. However, during the implementation of the Triple Flip, Board staff saw problems with the language. Those problems are:

- The amendments enacted by SB 1096 did not provide for rates that could change but set another fixed rate, this time the rate in effect on July 1, 2004, reduced by 0.25 percent;
- Those cities that were not at 1 percent prior to the Triple Flip (operative date of Triple Flip is July 1, 2004) could never go up to 0.75 percent;
- Cities that have ordinances with scheduled rate changes (e.g., rate on January 1, 2004 is 0.80 percent, rate on January 1, 2008 increases to 0.85 percent, and rate on January 1, 2010 increases to 0.95 percent and remains at that rate thereafter) would be stuck at 0.80 percent (minus 0.25 percent) for the duration of the Triple Flip;
- Cities with revenue sharing agreements would be restricted to the rate as specified in their ordinance on January 1, 2004, for the duration of the Triple Flip, even if the revenue sharing agreement expired before the end of the Triple Flip;
- New cities organizing during the Triple Flip period that wished to enter into revenue sharing agreements with their counties would be almost forced to establish an initial tax rate of 0.75 percent and then vary their rate pursuant to their agreement rather than establish the initial rate at the rate the new city and the county desire.

Board staff believes that the amendment to Section 7203.1 in this bill resolves these problems.

4. **Related legislation.** **SB 1115 (Committee on Budget and Fiscal Review)** is identical to this bill. **SCA 4 (Resolution Chapter 133, Torlakson)** places a constitutional amendment to protect local government revenues before the voters at the November 2, 2004 general election (Proposition 1A – Protection of Local Government Revenues). Among other things, this constitutional amendment would: (1) prohibit the Legislature from restricting the authority of a city or county to impose a rate under the Bradley-Burns Local Sales and Use Tax Law, as that law reads on November 2, 2004; (2) allow the Legislature to change the method of distributing local use tax revenues in order to participate in an interstate compact or to comply with federal law; and (3) prohibit the Legislature from extending the revenue exchange period (also known as the “Triple Flip”). This constitutional amendment would supersede Proposition 65, the local government initiative, also on the November 2, 2004 general election ballot, if both measures are approved and this measure receives a higher number of votes.

Assembly Bill 2207 (Levine) Chapter 181
Statistical Data – San Fernando Valley

Effective January 1, 2005. Amends Section 11093 of the Government Code.

BILL SUMMARY

This bill requires state agencies that prepare and maintain data and statistics on cities, to make a separate breakdown of the San Fernando Valley.

Sponsor: Valley Industry and Commerce Association

LAW PRIOR TO AMENDMENT

Under current Government Code provisions, the Department of Finance, the State Department of Health Services, and the Department of Transportation are required to make a separate breakdown of the San Fernando Valley when preparing or maintaining any statistical analyses by city. Also, under current law, a state agency is not required to prepare or maintain any statistical information unless: (1) information is currently being prepared or maintained by city; or (2) a state agency voluntarily prepares or maintains information by city.

Under current Bradley-Burns Uniform Local Sales and Use Tax Law, the Board is required to collect and maintain local tax data by city, county, or city and county. Under current Transactions and Use Tax Law, the Board is required to collect and maintain local tax data by special taxing district. The Board, in its annual report, publishes the following statistical data: (1) State Sales and Use Tax Statistics by County; (2) Revenues Distributed to Cities and Counties From Local Sales and Use Taxes; (3) Revenues Distributed to Counties From County Transportation Tax; and (4) Revenues Distributed to Special Districts From Transactions and Use Tax.

The Board publishes a quarterly report titled "Taxable Sales in California." This report provides taxable sales data by: (1) Statewide Taxable Sales, By Type of Business; (2) Taxable Sales, By County; and (3) Taxable Sales, By City. The quarterly report is available on the Board's website at <http://www.boe.ca.gov/news/tsalescont03.htm>. The Board also prepares an annual publication titled, Taxable Sales in California (Sales & Use Tax). This publication contains taxable sales data by: (1) Statewide Taxable Sales, By Type of Business; (2) Taxable Sales, By County; (3) Taxable Sales in the 36 Largest Counties, By Type of Business; (4) Taxable Sales in the 22 Smallest Counties, By Type of

Business; (5) Taxable Sales in the 272 Largest Cities, By Type of Business; and (6) Taxable Sales in All Cities Except the 272 Largest.

AMENDMENT

This bill adds Section 11093 to the Government Code to provide that any state agency or department that develops and maintains data and statistics on the municipal level, is required to make a separate breakdown of the San Fernando Valley. This bill also provides that if the use of a tax area code is required in order to comply with the provisions of this bill, an alternate method may be used to determine the separate breakdown of the San Fernando Valley. This bill revises the existing boundary definition for the San Fernando Valley to include that portion of the City of Los Angeles, as described. This bill also requires the City of Los Angeles to provide all necessary data.

COMMENTS

- 1. Purpose.** The purpose of this bill is to promote the development of reliable statistical information for the San Fernando Valley area by expanding and enforcing existing data collection efforts. According to the author's office, San Fernando Valley is a "distinctive region of the City of Los Angeles with its own set of issues, challenges, and priorities." This information will permit more accurate planning for transportation, infrastructure, education, land use, and economic development for this "geographically distinct region."
- 2. Key amendments.** The **May 18, 2004 amendments** added coauthors and provided that, if the use of a tax area code is required to comply with the provisions of this bill, an alternate method may be used to determine the separate breakdown of the San Fernando Valley.
- 3. Amendments allow previous study method to be used.** In 2002, the Los Angeles County Local Area Formation Commission (LALAFCO) compiled data of local sales tax revenues attributable to the San Fernando Valley. The LALAFCO asked Board staff to review the data for accuracy. Specifically, the LALAFCO asked the Board to verify its estimate of local tax revenues on consolidated accounts where some of the business locations are located within the City of Los Angeles and others are located within the San Fernando Valley. Board staff reviewed the data and found that the estimate of local tax revenues on consolidated accounts was off by about 10 percent.

A consolidated account is a sales tax account with two or more selling locations (also called "sales outlets") for which a single tax return is filed. For sales outlets located within the same city, a single amount of local tax may be reported. However, the majority of consolidated accounts provide a breakdown of all sales outlets and the local tax attributable to those outlets.

While the City of Los Angeles is given information regarding the total local tax revenues attributable to sales outlets in the city, it is not provided with the detail by sales outlet. As such, the city cannot allocate the revenues specifically for the

San Fernando Valley. Board staff was able to verify the data on most of the consolidated accounts in a minimal amount of time.

Therefore, if the City of Los Angeles were to compile data on the San Fernando Valley like LALAFCO did in 2002, with the Board performing a minimal amount of verification, such work could be done with insignificant costs (i.e., under \$10,000) to the Board. However, any other method that would require the Board to compile all the data would result in significant costs to the Board.

4. **Tax area code system would be costly.** As previously stated, the Board maintains two types of data by city: distributions of local sales and use tax revenues and taxable sales. This information is collected and maintained using a tax area code system. All registered permit holders are assigned a tax area code. A tax area code is a twelve (12) digit number that identifies the city and county in which the account is located, as well as any special districts or redevelopment areas. All newly incorporated cities are assigned a tax area code.

To implement the provisions of this bill using the Board's existing system, and not an alternative method that the bill now allows, the Board would have to treat the San Fernando Valley as a newly incorporated city. This would require creating a special tax area code for the San Fernando Valley. Once the tax area code is established, the Board would have to identify all accounts within the San Fernando Valley. The Board requires all newly incorporated cities to furnish maps and listings of street addresses. The Board would have to print out all 112,675 accounts currently within the City of Los Angeles and the surrounding areas. However, Board staff would have to review approximately 115,000 accounts to capture any accounts within the surrounding area of the City of Los Angeles that could be located within the San Fernando Valley. Using the street listings provided by the City of Los Angeles, Board staff would have to compare each business address from the Board's records to the city's street listing to identify those accounts within the San Fernando Valley.

Once the accounts have been identified, each account must be changed on the Board's registration system. This would require changing the tax area code, entering comments regarding the nature of the changes made, and other minor modifications. When changes have been made to the registration system, a listing of all accounts that were changed, as well as copies of maps and street listings, are forwarded to the appropriate district offices for distribution to personnel responsible for registration of new accounts.

Other tasks associated with setting up a newly incorporated city include: preparing written guidelines for audit and compliance staff; designing and printing a special mailer to be mailed with the tax returns to approximately 73,000 affected accounts, and revising various forms and publications.

STATE BOARD OF EQUALIZATION

If the Board were to make a separate breakdown of the San Fernando Valley using its tax area code system, because of the large volume of accounts, the costs would be substantial (i.e., over \$250,000 but under \$1 million). However, if the Board were allowed to use a more simplified method, with the City of Los Angeles providing all necessary data, the Board's costs would be reduced substantially.

Assembly Bill 2585 (Parra) Chapter 885
Kings County – Sales and Use Tax Revenues

Effective January 1, 2005. Adds Section 40608 to the Health and Safety Code.

BILL SUMMARY

This bill, among other things, requires the California Research Bureau (CRB), in conjunction with the Board of Equalization (BOE) and the Franchise Tax Board (FTB), by December 31, 2004, to calculate the state tax revenues attributable to Kings County for the fiscal year 2003-04. This bill also requires the CRB, in conjunction with the BOE and the FTB, by December 31, 2007, and December 31 for each following year, to calculate the state tax revenues attributable to Kings County for the preceding fiscal year.

Sponsor: Assembly Member Nicole Parra

LAW PRIOR TO AMENDMENT

The Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

Currently, the state portion of the sales and use tax rate is 6 percent. However, beginning July 1, 2004, the state sales and use tax rate will increase by 0.25 percent, from 6 to 6.25 percent. The revenues from the 0.25 percent state sales and use tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the budget deficit bonds.

The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent state sales and use tax is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);
- 0.25 percent is an additional state sales and use tax allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 And 6201.3 of the Revenue and Taxation Code);

- 0.50 percent state tax is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.50 percent state tax is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

AMENDMENT

This bill adds Section 40608 to the Health and Safety Code to require the CRB, in conjunction with the BOE and the FTB, by December 31, 2004, to calculate the state tax revenues attributable to the Joint Strike Fighter Impact Zone for the base fiscal year. This bill also requires the CRB, in conjunction with the BOE and the FTB, by December 31, 2007, and December 31 of each following year, to calculate the state tax revenues attributable to the Joint Strike Fighter Impact Zone for the preceding fiscal year.

This bill provides the following definitions:

- “Joint Strike Fighter Impact Zone” means Kings County;
- “Base fiscal year” means the 2003-04 fiscal year;
- “State tax revenues” includes revenues derived from the imposition of taxes under the Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), the Personal Income Tax Law (Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code), and the Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code).

This bill also states that the Legislature’s intent is to encourage the United States Navy to select Lemoore Naval Air Station (located in Kings County) as the Navy’s West Coast Operations Center to house the F-35 Joint Strike Fighter. It is estimated that as many as 10,000 new jobs will be generated in and around the site selected to house the F-35 Joint Strike Fighter, as well as increase economic activity by an estimated \$1 billion.

This bill also does the following:

- Provides that the District may develop and adopt by regulation, no later than January 1, 2008, a program to offset or mitigate the increased emissions of air contaminants as a result of the housing of the F-35 Joint Strike Fighter at Lemoore Naval Air Station;
- Provides that the Legislature, for the 2007-08 fiscal year, and each fiscal year thereafter, shall determine whether state funding should be provided in an amount based on the calculations of the state tax revenues attributable to Kings County to the District, for use in mitigating any increase in emissions of air contaminants that may result if the Lemoore Naval Air Station is chosen to be the West Coast Operations Center to house the F-35 Joint Strike Fighter.

COMMENTS

1. **Purpose.** The purpose of this bill is to generate more jobs in Kings County, as well as generate more economic activity.
2. **Key amendments.** The **June 29, 2004 amendments** required that emissions reductions achieved through the mitigation program be surplus, quantifiable, and permanent. The **May 20, 2004 amendments** did the following: (1) required the CRB, instead of the LAO, in conjunction with the BOE and the FTB, to calculate the state tax revenues attributable to Kings County; (2) specified that after the calculation has been made, the Legislature would determine whether state funding should be provided to the District; and (3) deleted the Joint Strike Fighter Impact Zone Account, and instead provided that any state funding should go directly to the District.
3. **The Board staff does not see a problem in complying with the provisions of this bill.** This bill requires the LAO, in conjunction with the BOE, by December 31, 2004, to calculate the state sales and use tax revenues for Kings County during the fiscal year 2003-04, and then on December 31, 2007, and each December 31 thereafter for the prior fiscal year. The Board staff does not see a problem in calculating the state sales and use tax revenues for the prior fiscal year by each December 31st.
4. **Definition of state tax revenues.** This bill defines the term "state tax revenues" to include revenues derived from taxes imposed under the Sales and Use Tax Law (Part 1 of Division 2 of the Revenue and Taxation Code (R&T Code)). The following is a breakdown of the sales and use tax rates imposed under Part 1 of Division 2 of the R&T Code:

Rate	State – Type of Fund	Part 1, Div. 2 of R&T Code
4.75 %	General Fund	6051, 6201
0.25 %	General Fund	6051.3, 6201.3
0.50 %	Local Revenue Fund	6051.2, 6201.2
<u>Operative July 1, 2004</u> 0.25 %	Fiscal Recovery Fund	6051.5, 6201.5

Does the Legislature want the calculations based on revenues credited to the Local Revenue Fund and used for local government purposes? Does the Legislature want the calculations based on revenues credited to the Fiscal Recovery Fund and used for the repayment of the 2003-04 budget deficit bonds?

Assembly Bill 3020 (Koretz) Chapter 685

Joint Enforcement Strike Force on the Underground Economy

Effective January 1, 2005. Among its provisions, amends Section 329 of the Unemployment Insurance Code.

BILL SUMMARY

This bill eliminates the January 1, 2006 sunset date for the Joint Enforcement Strike Force on the Underground Economy.

Sponsor: Assembly Member Koretz

LAW PRIOR TO AMENDMENT

Under current law, Section 329 of the Unemployment Insurance Code designates the Director of the Employment Development Division (EDD) as Chairperson of the Joint Enforcement Strike Force on the Underground Economy (Strike Force). The section also requires the Strike Force to include representatives of the EDD, Department of Consumer Affairs, the Department of Industrial Relations, and the Office of Criminal Justice Planning. Other agencies such as the Franchise Tax Board, the State Board of Equalization, and the Department of Justice are encouraged to participate. However, the statute will remain in effect only until January 1, 2006.

Under current law, the Strike Force is given the following duties:

- Facilitate and encourage the development and sharing of information by the participating agencies necessary to combat the underground economy.
- Improve the coordination of activities among the participating agencies.
- Develop methods to pool, focus, and target the enforcement resources of the participating agencies in order to deter tax evasion and maximize recoveries from blatant tax evaders and violators of cash-pay reporting laws.
- Reduce enforcement costs wherever possible by eliminating duplicative audits and investigations.

AMENDMENT

Among its provisions, this bill amends Section 329 of the Unemployment Insurance Code to eliminate the scheduled sunset date of January 1, 2006, allowing the Joint Enforcement Strike Force on the Underground Economy to continue indefinitely.

BACKGROUND

The Board of Equalization is a core member of the multiagency Strike Force. The Strike Force was created by Executive Order W-66-93 on October 26, 1993 and subsequently codified through Senate Bill 1490 (Ch. 1117) in 1994. The Strike Force has achieved significant enforcement results in all phases of its efforts. Joint efforts among the different agencies have proven to be very effective. Collective enforcement capability allows participating agencies to address multiple rather than single violations of law, such as the Employment Enforcement Task Force efforts as explained in the Revenue Estimate comments. The multiple enforcement efforts with associated citations, penalties, and assessments has had a significant effect on underground economy businesses. The effect has been to drive these businesses into the legitimate economy or to put them out of business. This reduces the pressure of unlawful competition on honest businesses.

Senate Bill 319 (Ch. 306, Stats. 1999) extended the sunset date provision from January 1, 2000 to January 1, 2006.

COMMENTS

1. **Purpose.** The purpose of this bill is to extend the life of the successful Strike Force indefinitely.
2. **Key amendments.** Previous versions of this bill contained provisions relating to taxation of cigarette and tobacco products. The **August 23, 2004** amendments added additional Labor Code provisions that would not impact the Board.
3. **The Board has benefited from its participation in the Task Force.** Although the primary source of unreported state revenues generated by the Strike Force are from payroll taxes, the Board has been able to enhance its presence among a certain segment of bars, restaurants, and clubs which were seriously underreporting their sales tax liabilities.

Assembly Bill 3071 (Assembly Revenue and Taxation Committee) Chapter 353
Technical - Repeal of Obsolete Section

Effective January 1, 2005. Repeals Section 7057 of the Revenue and Taxation Code.

BILL SUMMARY

This bill repeals obsolete Section 7057 of the Revenue and Taxation Code.

Sponsor: Board Member John Chiang

LAW PRIOR TO AMENDMENT

Section 7057 of the Revenue and Taxation Code requires the Board to ascertain whether or not a person registering for a seller's permit is required to register as an employer under Section 1086 of the Unemployment Insurance Code, and register the person accordingly. Seller's permit applications currently used by the Board request taxpayers to answer several questions related to employment taxes. These questions were included on the Board's applications so the Board could comply with the requirements of Section 7057. When information provided by the applicant indicated they also needed to register as an employer, the seller's permit application was photocopied and forwarded to the Employment Development Department (EDD).

AMENDMENT

Among its provisions, this bill repeals Section 7057 of the Revenue and Taxation Code so that the Board would no longer be required to ascertain whether an applicant for a seller's permit is required to register as an employer with the EDD.

BACKGROUND

In late 2000, EDD requested that the Board no longer provide them with photocopies of seller's permit applications since they no longer utilized them to register taxpayers for employment taxes. A letter dated October 10, 2003 from EDD Director, Mr. Michael Bernick, confirms EDD no longer requires the Board to provide them with this information. According to Mr. Bernick, photocopies of seller's permit applications are not useful to EDD since most employers register with EDD directly. Since EDD no longer requires the Board to register employers as required in Section 7057, this section is obsolete.

COMMENT

Purpose. To repeal an obsolete section of the Revenue and Taxation Code.

Senate Bill 1096 (Budget and Fiscal Review Committee) Chapter 211***Budget Trailer Bill – Triple Flip***

Effective August 5, 2004. Among its provisions, adds Section 97.68 to, and amends Section 7203.1 of, the Revenue and Taxation Code.

BILL SUMMARY

This is a budget trailer bill to enact statutory changes related to local government finance issues as part of the 2004-05 Budget Act. The provisions take effect immediately. Among its provisions, this bill does the following:

- Provides that the annual estimate prepared by the Department of Finance (DOF), is based on the actual amount of local sales and use tax revenues transmitted to cities and counties for the prior fiscal year (rather than taxable sales) and any projected growth on that amount for the current fiscal year as determined by the Board of Equalization (Board) and reported to the DOF by August 15th of each fiscal year during the fiscal adjustment period (also known as the “Triple Flip” period).
- Provides that, after the end of each fiscal year, the DOF, based on the actual amount of local sales and use tax revenues not transmitted to cities and counties for the prior fiscal year (rather than taxable sales), will adjust the estimate and notify the county auditors of the adjusted amount.
- After the fiscal adjustment period (“Triple Flip”) has ended, revises the final allocation of property tax revenues to ensure that the correct amount of replacement revenues have been provided to cities and counties.
- Provides that, during the fiscal adjustment period (“Triple Flip”), the applicable local sales and use tax rate is the rate specified in an ordinance on January 1, 2004, reduced by 0.25 percent.
- Provides legislative findings and declarations stating that this entire bill is a comprehensive revision to local government finances that will be an “interim measure” within the meaning of Proposition 65, the local government initiative on the November 2, 2004 general election ballot. Consequently, if Proposition 65 is approved by the voters, the effect and operation of this bill will be suspended pending approval of such an interim measure by the voters at the first statewide election occurring after the passage of Proposition 65.

Although this bill affects property tax, vehicle license fee, and sales and use tax revenues, this analysis deals primarily with the sales and use tax provisions. The property tax provisions are discussed generally only because it is related to the

sales tax provisions in this bill, but it is not within the scope of administration by the Board.

Sponsor: Committee on Budget and Fiscal Review

LAW PRIOR TO AMENDMENT

The Sales and Use Tax Law (commencing with Section 6001 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

Currently, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. However, beginning July 1, 2004, the state tax rate increased by 0.25 percent, from 6 to 6.25 percent, and the local tax rate decreased by 0.25 percent, from 1.25 to 1 percent. The revenues from the 0.25 percent state tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);
- 0.25 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city to impose a local sales and use tax rate of 1 percent that is credited against the county rate. Beginning on July 1, 2004, existing law reduces by 0.25 percent the rate that may be imposed by a county, from 1.25 to 1 percent, and by a city, from 1 to 0.75 percent. Existing law also provides that this reduction in the local tax rate will be increased by 0.25 percent when the DOF has made a specified notification to the Board, pursuant to Section 99006 of the Government Code, that the \$15 billion Economic Recovery bond has been repaid.

AMENDMENT

This bill enacts statutory changes related to local government as part of the 2004-05 Budget Act. This bill, among other things, does the following:

Amends Section 97.68 the Revenue and Taxation Code to do the following:

- Revises the definition of the “countywide adjustment amount.” The “countywide adjustment amount” is the total revenue loss of the county and each city in that county that is annually estimated by the DOF based on information provided by the Board and reported to the DOF by August 15th of each fiscal year, resulting from the 0.25 percent reduction in the local sales and use tax rate. Section 97.68 was amended to provide that this annual estimate prepared by the DOF will be based upon the amount of local sales and use tax revenues transmitted to cities and counties for the prior fiscal year (rather than taxable sales which have not been compiled by August 15th of each fiscal year) and any projected growth on that amount for the current fiscal year as determined by the Board and reported to the DOF on August 15th of each fiscal year. (DOF is required to notify each county auditor of the countywide adjustment amount by September 1st of each fiscal year.)
- Provides that at the end of each fiscal year the DOF will, based upon the actual amount of local sales and use tax revenues that were NOT transmitted for the prior fiscal year (rather than actual taxable sales), recalculate the countywide adjustment amount and notify the county auditor of this recalculated amount.
- Provides that, when the fiscal adjustment period (also known as the “Triple Flip”) has ended, all of the following apply:

If the fiscal adjustment period ends on an **October 1** of the fiscal year, the following applies:

- 1) The countywide adjustment amount for the current fiscal year is the sum of the following two amounts: (1) the total revenue loss of the county and each city in that county that is annually estimated by the DOF, based upon the actual local sales and use tax revenues transmitted to cities and counties for the *first quarter* of the prior fiscal year as determined by the Board and reported to the DOF by August 15th of that fiscal year; and (2) the difference between the amount allocated to the county and each city in that county for the prior fiscal year (this is an estimated amount) and the actual amount of local sales and use tax revenue that was *not* transmitted to the county and each city in that county for the prior fiscal year.
- 2) On or before January 31 of the current fiscal year, the county auditor will allocate to the county and each city in that county that portion of the countywide adjustment amount attributable to the county and each city in that county (prior to the Triple Flip ending, the county auditor will shift property tax revenues from the county ERAF to the SUTCF.

These property tax revenues are then allocated from the SUTCF to cities and counties twice a year in January and May).

- 3) On or before May 1 of the current fiscal year, the Board will report to the DOF the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the current fiscal year as a result of the 0.25 percent from the reduction in the local sales and use tax rate.
- 4) On or before May 1 of the current fiscal year, the DOF will determine the difference of the following two amounts: (a) the total revenue loss of the county and each city in that county that was estimated by the DOF, based upon the actual local sales and use tax revenues transmitted for the *first quarter* of the prior fiscal year as determined by the Board and reported to the DOF by August 15th of the current fiscal year; and (b) the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the current fiscal year. On or before May 1 of the current fiscal year, the DOF will notify each county auditor of these amounts.
- 5) If it is determined that any county or city received an excess amount of property tax revenues, the county auditor, on or before May 31 of the current fiscal year, will reallocate from the local entity to the county ERAF those excess amounts.
- 6) If it is determined that any county or city received a lesser amount of property tax revenues, the county auditor, on or before May 31 of the current fiscal year, will allocate from the county ERAF to the local entity those lesser amounts.

If the fiscal adjustment period ends on **January 1** of a fiscal year, the following applies:

- 1) The countywide adjustment amount for the current fiscal year is the sum of the following two amounts: (1) the total revenue loss of the county and each city in that county that is annually estimated by the DOF, based upon the actual local sales and use tax revenues transmitted to cities and counties for the *first and second quarters* of the prior fiscal year as determined by the Board and reported to the DOF by August 15th of that fiscal year; and (2) the difference between the amount allocated to the county and each city in that county for the prior fiscal year (this is an estimated amount) and the actual amount of local sales and use tax revenue that was *not* transmitted to the county and each city in that county for the prior fiscal year.
- 2) The county auditor will allocate the countywide adjustment amount to the county and each city in that county as follows: one-half of this amount will be allocated on or before January 31 of the current fiscal year and the other one-half will be allocated on or before May 31 of the current fiscal year.

- 3) On or before June 30 of the current fiscal year, the Board will report to the DOF the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the current fiscal year as a result of the 0.25 percent from the reduction in the local sales and use tax rate.
- 4) On or before June 30 of the current fiscal year, the DOF will determine the difference of the following two amounts: (a) the total revenue loss of the county and each city in that county that was estimated by the DOF, based upon the actual local sales and use tax revenues transmitted for the *first and second quarters* of the prior fiscal year as determined by the Board and reported to the DOF by August 15th of the current fiscal year; and (b) the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the current fiscal year. On or before June 30 of the current fiscal year, the DOF will notify each county auditor of these amounts.
- 5) If it is determined that any county or city received an excess amount of property tax revenues, the county auditor, on or before January 31 of the following fiscal year, will reallocate from the local entity to the county ERAF those excess amounts.
- 6) If it is determined that any county or city received a lesser amount of property tax revenues, the county auditor, on or before January 31 of the following fiscal year, will allocate from the county ERAF to the local entity those lesser amounts.

If the fiscal adjustment period ends on **April 1** of a fiscal year, the following applies:

- 1) On or before May 1 of the current fiscal year, the DOF will determine and report to each county auditor that portion of the countywide adjustment amount that is attributable to the estimated local sales and use tax revenue losses for the fourth quarter of the current fiscal year for the county and each city in that county.
- 2) The county auditor will reduce the total amount that is otherwise required to be allocated in May of the current fiscal year from the Sales and Use Tax Compensation Fund to the county and each city in that county by the estimated amount for the fourth quarter of the current fiscal year (as previously described under bullet 1). After the May allocations have been made, the county auditor will transfer any moneys remaining in the Sales and Use Tax Compensation Fund to the county ERAF.
- 3) On or before January 1 of the next fiscal year, the Board will report to the DOF the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the prior fiscal year as a result of the 0.25 percent from the reduction in the local sales and use tax rate.
- 4) On or before January 1 of the current fiscal year, the DOF will determine the difference of the following two amounts: (a) the actual

amount of local sales and use tax revenues transmitted to the county and each city in that county for the prior fiscal year and adjusted by the estimated amount for the fourth quarter of the prior fiscal year; and (b) the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the prior fiscal year. On or before January 1 of the current fiscal year, the DOF will notify each county auditor of these amounts.

- 5) If any county or city receives an excess amount of property tax revenues, the county auditor, on or before January 31 of the current fiscal year, will reallocate from the local entity to the county ERAF those excess amounts.
- 6) If any county or city receives a lesser amount of property tax revenues, the county auditor, on or before January 31 of the current fiscal year, will reallocate from the county ERAF to the local entity those lesser amounts.

If the fiscal adjustment period ends on **July 1** of a fiscal year, the following applies:

- 1) On or before January 1 of the current fiscal year, the Board will notify the DOF of the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the prior fiscal year.
- 2) On or before January 31 of the current fiscal year, the DOF will determine the difference of the following two amounts: (a) the actual amount of local sales and use tax revenues allocated to the county and each city in that county for the prior fiscal year from the Sales and Use Tax Compensation Fund; and (b) the actual amount of local sales and use tax revenues that was *not* transmitted to the county and each city in that county for the prior fiscal year. On or before January 31 of the current fiscal year, the DOF will notify each county auditor of these amounts.
- 3) If any county or city receives an excess amount of property tax revenues, the county auditor, on or before January 31 of the current fiscal year, will reallocate from the local entity to the county ERAF those excess amounts.
- 4) If any county or city receives a lesser amount of property tax revenues, the county auditor, on or before January 31 of the current fiscal year, will reallocate from the county ERAF to the local entity those lesser amounts.

Amends Section 7203.1 of the Revenue and Taxation Code to provide that, during the revenue exchange period (synonymous with “fiscal adjustment period” and also known as the “Triple Flip” period), the applicable local sales and use tax rates are the rates specified in a local ordinance as of January 1, 2004, reduced by 0.25 percent.

Provides legislative findings and declarations that the provisions of this bill are in its entirety an “interim measure” within the meaning of Proposition 65. If Proposition

65, The Local Taxpayers and Public Safety Protection Act, on the November 2, 2004 general election ballot, is approved by the voters, that the effect and operation of this bill would be suspended pending approval of such interim measure by the voters at the first statewide election occurring after the passage of Proposition 65.

The provisions of this bill became effective on August 5, 2004.

BACKGROUND

The original "Triple Flip" bills, Assembly Bill 7x (Chapter 13 of the First Extraordinary Session, Oropeza) and Assembly Bill 1766 (Chapter 162, Committee on Budget) were signed by Governor Davis on August 2, 2003, as part of the 2003-04 Budget Plan. AB 7x enacted the California Fiscal Recovery Financing Act and authorized the issuance of \$10.7 billion in bonds to finance the cumulative 2002-03 budget deficit. AB 7x would have increased the state tax rate by 0.50 percent but would have decreased the local tax rate by 0.50 percent (cities and counties would be reimbursed for their local tax revenue losses through property tax revenues). The revenues from the 0.50 percent state sales and use tax increase would be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit-financing bonds.

AB 1766 implemented the property tax component of the "Triple Flip." Under AB 1766, cities and counties are reimbursed for the 0.50 percent reduction in the local sales and use tax rate (in AB 7x) through property tax revenues. Property tax revenues otherwise allocated to the ERAF would be diverted to the Sales and Use Tax Compensation Fund (SUTCF) established in each county. The state, in turn, would make schools whole with increased General Fund support, as required under Proposition 98. The provisions of AB 7x and AB 1766 were to become operative on July 1, 2004.

On December 12, 2003, Governor Schwarzenegger signed Assembly Bill 9 (Chapter 2 of the Fifth Extraordinary Session, Oropeza), which reduced the amounts proposed under the original "Triple Flip" bills (AB 7x and AB 1766). AB 9 enacted the Economic Recovery Bond Act and authorized the issuance of up to \$15 billion of bonds to finance the accumulated budget deficit. The voters approved Governor Schwarzenegger's \$15 billion bond measure (Proposition 57) on March 2, 2004. AB 9 became operative July 1, 2004.

AB 9, among other things, reduces the increase in the state portion of the sales and use tax rate, from 0.50 percent to 0.25 percent (dedicated to the repayment of the deficit bonds), and decreases the related reduction in the local sales and use tax rate from 0.50 percent to 0.25 percent (local governments will be reimbursed for their local tax revenue losses with increased property tax revenues). This bill requires that the revenues from the 0.25 percent state sales and use tax rate increase be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

As previously stated, the provisions of AB 9 provide that cities and counties will be reimbursed for the reduction in the local sales and use tax revenues through

property tax revenues from the ERAF. The DOF, in conjunction with Board staff, will prepare an annual estimate by September 1 of each fiscal year of the local sales and use tax revenue losses attributable to the reduction in the local sales and use tax rate. This estimate is based on prior year distributions of local sales and use tax revenues. Cities and counties will receive the property tax replacement revenues twice a year—in January and May. At the end of each fiscal year, the property tax replacement revenues will be adjusted to reconcile with the actual amount of local sales and use tax revenues *not* transmitted as a result of the 0.25 percent reduction in the local sales and use tax rate.

COMMENTS

1. **Purpose.** The purpose of this bill is to enact statutory changes to the 2004-05 Budget Act, and make technical corrections to the Triple Flip.
2. **Key amendments.** The **July 27, 2004 amendments** incorporated statutory changes related to the local government portion of the 2004-05 Budget Act and made technical amendments, including certain amendments requested by Board staff, to the Triple Flip. The amendments related to the Triple Flip are as follows: (1) bases the annual estimate of property tax allocations on local sales and use tax revenues transmitted to cities and counties (rather than taxable sales which have not been compiled by each August 15th) in the prior fiscal year and any projected growth for the current fiscal year; (2) provides that the local sales and use tax rate is the rate as specified in an ordinance as of January 1, 2004, reduced by 0.25 percent; and (3) provides for the final allocation of property tax revenues to ensure that the correct amount of replacement revenue has been provided.
3. **This bill makes technical corrections to the “Triple Flip” related to the annual estimate, the annual settle-up, and the wind-up process (when the Triple Flip ends).** There are two calculations performed during the Triple Flip period—the annual estimate and the annual settle-up. The provisions related to the annual estimate were amended to replace taxable sales with actual amounts of local sales and use tax revenues transmitted to cities and counties. The reason for amending this provision was because the Board has not compiled taxable sales for the prior fiscal year by each August 15th, but it does have payments of local sales and use tax revenues made to local jurisdictions by August 15th. Regarding the annual settle-up, this provision was amended to replace actual taxable sales with actual amounts of local sales and use tax revenues *not transmitted* for the prior fiscal year. This provision was amended for two reasons: (1) Board staff has not compiled actual taxable sales for the prior fiscal year by each August 15th; and (2) the amount of local sales and use tax revenues *not transmitted* (which is provided to cities and counties on their quarterly statements) represents the amount of local tax revenue losses due to the 0.25 percent reduction in the local tax rate and, therefore, is a better source to use for the settle-up calculation.

Regarding the wind-up process (when the Triple Flip ends), amendments were made to provide more detailed instructions to ensure that the correct amount of replacement revenue (i.e., property tax revenues) has been provided.

4. **Cities are able to impose a rate of less than 0.75 percent defaulting the balance to the county.** Section 7203.1 was added by AB 9 (Stats. 2003, Committee on Budget) and set the rate that a county could impose at 1 percent and the city rate at 0.75 percent. By setting the rate at a fixed amount, cities were prohibited from imposing a rate of less than 0.75 percent defaulting the balance of the 0.75 percent rate to the county in which the city is located. This bill amends Section 7203.1 to allow cities to impose a rate as specified in an ordinance on January 1, 2004, reduced by 0.25 percent. This amendment allows a city and county to share the city's 0.75 percent local tax.
5. **Related legislation. SCA 4 (Resolution Chapter 133, Torlakson)** places a constitutional amendment to protect local government revenues before the voters at the November 2, 2004 general election (Proposition 1A – Protection of Local Government Revenues). Among other things, this constitutional amendment would: (1) prohibit the Legislature from restricting the authority of a city or county to impose a rate under the Bradley-Burns Local Sales and Use Tax Law, as that law reads on November 3, 2004; (2) allow the Legislature to change the method of distributing local use tax revenues in order to participate in an interstate compact or to comply with federal law; and (3) prohibit the Legislature from extending the revenue exchange period (also known as the “Triple Flip”). This constitutional amendment would supersede Proposition 65, the local government initiative, also on the November 2, 2004 general election ballot, if both measures are approved and this measure receives a higher number of votes.

Senate Bill 1100 (Senate Committee on Budget and Fiscal Review) Chapter 226

Vehicles, Vessels and Aircraft

Tax Amnesty

Tax levy; effective August 16, 2004. Among its provisions, amends Section 6592 of, amends, repeals, and adds Section 6248 of, and adds Article 2 (commencing with Section 7070) of Chapter 8 of Part 1 of Division 2 of, the Revenue and Taxation Code.

BILL SUMMARY

This Budget trailer bill, among other things unrelated to the Board, does the following: 1) provides that, for the period October 1, 2004 through July 1, 2006, it shall be rebuttably presumed that, except as specified, a vehicle, vessel, or aircraft purchased outside this state and brought into California within 12 months from the date of purchase is purchased for use in California and is subject to California use tax, except as specified, and 2) requires the Board and the Franchise Tax Board (FTB) to administer a tax penalty amnesty program for a two-month period beginning February 1, 2005 and ending March 31, 2005, or any other two-month period ending June 30, 2005, as specified.

Sponsor: Senate Budget and Fiscal Review Committee

LAW PRIOR TO AMENDMENT

Vehicles, Vessels and Aircraft

Revenue and Taxation Code Section 6248

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed 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, or in the case of a vehicle or vessel, to the Department of Motor Vehicles.

Under current law and Board regulations, a vehicle, vessel, or aircraft purchased by a California resident is presumed to have been purchased for use in California and is subject to the California use tax. Also, a vehicle, vessel, or aircraft purchased by a nonresident is presumed to have been purchased for use in California if it enters this

state within the first 90 days of ownership. These transactions are subject to the tax unless all of the following occur:

- The purchaser takes title to and possession of the vehicle, vessel, or aircraft while it is out of state; and
- The purchaser makes the first functional use of it outside the state; and
- The purchaser uses it out of state for more than 90 days before the vehicle, vessel, or aircraft first enters California.

Under Regulation 1620, *Interstate and Foreign Commerce*, in determining the 90-day period of use outside California, the time is not counted when the vehicle, vessel, or aircraft was in shipment, or in storage for shipment, to California.

If the vehicle, vessel, or aircraft is purchased outside California and is first functionally used outside California but enters the state within the first 90 days of purchase (exclusive of time of shipment or storage for shipment to California), the vehicle, vessel, or aircraft is presumed to have been purchased for use in California unless it is used or stored outside the state more than 50 percent of the time during the six-month period immediately following the first entry into California.

AMENDMENT

This bill amends Section 6248 of the Sales and Use Tax Law to expand the existing presumption to a vehicle, vessel, or aircraft purchased outside this state. Specifically, the bill provides that, for the period October 1, 2004 through July 1, 2006, it shall be rebuttably presumed that a vehicle, vessel, or aircraft bought outside this state and brought into this state during the first 12 months of the date of purchase, was acquired for storage, use, or other consumption in this state and is subject to use tax if any of the following occur:

- (a) The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the Vehicle Code.
- (b) In the case of a vehicle, the vehicle was subject to registration under Chapter 1 (commencing with Section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership.
- (c) In the case of a vessel or aircraft, the vessel or aircraft was subject to property tax in this state during the first 12 months of ownership.
- (d) The vehicle, vessel, or aircraft was used or stored in this state more than one-half of the time during the first 12 months of ownership.

The bill further provides that this presumption may be controverted by documentary evidence, that the vehicle, vessel, or aircraft was purchased for use outside of this state during the first 12 months of ownership, that shall include, but not be limited to, evidence of registration of that vehicle, vessel, or aircraft with the proper authority outside of this state. In addition, the bill clarifies that the provisions do not apply to any vehicle, vessel, or aircraft used in interstate or foreign commerce pursuant to regulations prescribed by the Board.

And, finally, the bill specifies that an aircraft or vessel shall not be deemed to be purchased for use in this state if that aircraft or vessel is brought into this state for the purpose of repair, retrofit, or modification of the aircraft or vessel, provided that no more than 25 hours of airtime or sailing time are logged for that purpose, as specified.

The provisions became effective on October 1, 2004 and will be repealed effective July 1, 2006. The bill requires the Legislative Analyst's Office to prepare a report by June 30, 2006 of the economic impact on the industry of the proposed changes to Section 6248.

BACKGROUND

Similar provisions were also contained in Assembly Member Levine's AB 694, introduced in 2003 but held in the Senate, and AB 2107, which was held in the Assembly. These provisions were originally prompted by a *Sacramento Bee* article concerning a perceived tax loophole with respect to current law. The article cited instances in which California purchasers of yachts from California yacht retailers were arranging delivery of the yachts outside the territorial waters of California, leaving them in Mexico for the 90-day period, and bringing them into California and escaping the California sales or use tax.

IN GENERAL

The California sales tax generally does not apply to a transaction when a California retailer sells an item and ships it directly to the purchaser at an out-of-state location, for use outside California. The sale is regarded under the law as a sale in interstate commerce. In general, the sale is not taxable if the retailer:

- Ships the product directly to the purchaser, using his or her own delivery vehicle or another means of transport that he or she owns; or
- Ships the product by delivering it to a common carrier, contract carrier, customs broker, export packer, or forwarding agent.

In most cases, if a purchaser or his or her representative takes possession of an item in California — even temporarily — the sale does not qualify for the sales tax exemption. In addition, if the retailer delivers an item to a California resident at an out-of-state location, tax does apply, unless the purchaser states, in writing, that the item was purchased for use outside California. Nonetheless, if the retailer knows that the customer plans to use the item in California within 90 days of its purchase, the sale is subject to tax.

COMMENTS

1. **Purpose.** The purpose of this measure is to address the revenue losses associated with the 90-day rebuttable presumption provisions in law, thereby increasing the State's revenues.
2. **Bill will not be problematic to administer.** This bill will actually minimize the staff time associated with investigating claimed exemptions, since the bill essentially shifts the burden of proof onto the purchaser to establish the exemption. Prior to enactment of this measure, the transaction was generally

deemed exempt if it met the 90-day test. Enactment of this measure will create the presumption of taxability if the transaction meets the criteria in the bill, and the responsibility will be placed on the purchaser to provide the necessary documentation to the Board to overcome that presumption of taxability.

3. **Should the law be more stringent?** The Board's Consumer Use Tax Section routinely investigate transactions in which California purchasers take delivery of vehicles, vessels, or aircraft outside this state and claim an exemption for the California use tax under the current 90-day presumption provisions. According to that section, staff often finds that purchasers are residents of California who were informed of the use tax exemption by dealers or brokers who are using the tax avoidance opportunity as a sales incentive. Often the purchasers' travel itinerary is constructed around the exemption requirements established by law so as to avoid paying tax. Some would argue that this is not a tax loophole but simply good tax planning.

LAW PRIOR TO AMENDMENT

Tax Amnesty
*Revenue and Taxation Code Section 6592
 and Article 2 (commencing with Section 7070)*

Under existing law, there are an array of penalties that are imposed under a variety of provisions of the Sales and Use Tax Law. These penalties are as follows:

1. For late payments generally, a penalty of 10 percent of the amount of all unpaid tax is added to any tax not paid in whole or in part within the time required by law.
2. For prepayments (for taxpayers with taxable sales in excess of \$17,000 per month, who are required to make two prepayments of the tax during each quarter) the following penalties apply:
 - Taxpayers who fail to make a prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due and who files a timely return and payment for that quarterly period is required to pay a penalty of 6 percent of the amount of prepayment, as specified, for each of the periods during that quarterly period for which a required prepayment was not made.
 - If the failure to make such a prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, the penalty is 10 percent instead of 6 percent.
 - Taxpayers who fail to make a timely prepayment, but who makes the prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due, is required to pay a penalty of 6 percent of the amount of the prepayment.

- If any part of a deficiency in prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, a penalty of 10 percent of the deficiency is required to be paid.
3. A penalty of 25% applies to the amount of prepayment due but not paid by any distributor or broker of motor vehicle fuel who fails to make a timely remittance of the prepayment as required by law.
 4. A penalty of 10 percent applies to the amount of prepayment due but not paid by any producer, importer, or jobber of fuel who fails to make a timely remittance of the prepayment as required by law. This penalty is 25 percent if the producer, importer, or jobber knowingly or intentionally fails to make a timely remittance.
 5. A purchaser of a vehicle, vessel or aircraft who registers it outside this state for the purpose of evading the payment of sales or use taxes is liable for a penalty of 50 percent of any tax determined to be due on the sales price of the vehicle, vessel or aircraft.
 6. Any person who fails to file a timely return is required to pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
 7. Any person remitting taxes by electronic funds transfer is required to, on or before the due date of the remittance, file a return for the preceding reporting period in the form and manner prescribed by the Board. Any person who fails to timely file the required return is required to pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
 8. A penalty of 10 percent of the amount of the tax specified in a determination is added to deficiency determinations if any part of the deficiency for which the determination is imposed is due to negligence or intentional disregard of the law.
 9. A penalty of 25 percent of the amount of the tax specified in a deficiency determination is added in cases of fraud or intent to evade the law or in the case of a determination for failure to file a return, if that failure is due to fraud or an intent to evade the law.
 10. A penalty of 50 percent applies to the taxes imposed upon any person who, for the purpose of evading the payment of taxes, knowingly fails to obtain a valid permit prior to the date in which the first tax return is due. The 50 percent penalty applies to the taxes determined to be due for the period during which the person engaged in business in this state as a seller without a valid permit and may be added in addition to the 10 percent penalty for failure to file a return. However, the 50 percent penalty does not apply if the taxable sales or purchases over the period during which the person was engaged in business without a valid permit averaged \$1,000 or less per month.
 11. A penalty of 10 percent of the amount of the tax specified in the determination shall be added to any determination not paid within the time required by law.

12. A penalty of 10 percent applies to the taxes imposed upon any person who knowingly issues a resale certificate for personal gain or to evade the payment of taxes while not actively engaged in business as a seller. The penalty is 10 percent of the amount of tax or \$500, whichever is greater, if the purchase is made for personal gain or to evade payment of taxes.
13. Every holder of a direct payment permit who gives an exemption certificate to a retailer for the purpose of paying that retailer's tax liability directly to the Board must make a proper allocation of that retailer's local sales and use tax liability and also its district transactions and use tax liability if applicable. Such allocation must be made to the cities, counties, city and county, redevelopment agencies, and district to which the taxes would have been allocated if they had been reported by that retailer. Allocations must be submitted to the Board in conjunction with the direct payment permit holder's tax return on which the taxes are reported. If the local and district taxes are misallocated due to negligence or intentional disregard of the law, a penalty of 10 percent of the amount misallocated is imposed.
14. Any person making sales to an operator of a catering truck who has been required by the Board to obtain evidence that the operator is the holder of a valid seller's permit and who fails to comply with that requirement is liable for a penalty of \$500 for each failure to comply.
15. Any retail florist who fails to obtain a seller's permit before engaging in or conducting business as a seller is liable, in addition to any other applicable penalty, for a penalty of \$500.

Under current law, any person who fails to pay tax to the state by the due date of that tax shall be assessed interest at the modified adjusted rate per month from the date the tax became due and payable to the state until the date of payment.

Current law provides different statute of limitations for various circumstances. Generally, the statute of limitations is 3-years from the date the return is due or the date the return is filed, whichever is later. In the event no return has been filed, the statute of limitations is 8-years from the date the return was due. If the taxpayer is guilty of fraud or intent to evade the tax, the statute of limitations is indefinite.

Under existing law, the Board administers a voluntary disclosure program, as authorized under Revenue and Taxation Code Sections 6487.05 and 6487.06. Under these sections, unregistered out-of-state retailers and California purchasers may voluntarily register with the Board and may be able to limit their liability for tax, penalties and interest due. Ordinarily, if the Board finds that an out-of-state retailer is liable for tax on its sales to California consumers, or a California purchaser owes use tax on its untaxed purchases, and that out-of-state retailer or California purchaser failed to file sales and use tax returns and report that tax, the law allows the Board to issue a deficiency determination for tax, interest, and penalties owed as long back as 8 years. Under the voluntary disclosure program, if an out-of-state retailer or California purchaser qualify, the billing period is limited to 3 years and relief of penalties may be provided.

AMENDMENT

This bill requires the Board to administer a sales and use tax penalty amnesty program for the period beginning on February 1, 2005 and ending March 31, 2005, or any other period ending no later than June 30, 2005. The amnesty program applies to sales and use tax liabilities due and payable for tax reporting periods beginning before January 1, 2003.

The tax amnesty program applies to any taxpayer who meets the following requirements:

1. Files a completed amnesty application with the Board.
2. For any taxpayer that has filed for bankruptcy protection under Title 11 of the United States Code, submits an order from a Federal Bankruptcy Court allowing the taxpayer to participate in the amnesty program.
3. Within 60 days after conclusion of the tax amnesty period, does all of the following:
 - Files completed tax returns for all tax reporting periods which have not been previously filed and files amended tax returns for all tax reporting periods in which an underreported tax liability exists.
 - Pays in full the taxes and interest due for all periods for which amnesty is requested, or applies for an installment payment agreement.
 - For taxpayers with outstanding tax liabilities due and payable for reporting periods beginning prior to January 1, 2003, pays in full the taxes and interest due for each period for which amnesty is requested, or applies for an installment payment agreement.

Taxpayers may request to enter into an installment payment agreement in lieu of full payment provided the final payment under the terms of the agreement is due and is paid no later than June 30, 2006. Failure by the taxpayer to fully comply with the terms of the installment payment agreement will result in the waiver of penalties null and void and the total amount of tax, interest, and all penalties will be due and payable immediately.

As consideration for taxpayers participating in the amnesty program, the Board will waive all penalties normally imposed under the sales and use tax law for the reporting periods for which tax amnesty is allowed for the nonreporting or underreporting of tax liabilities, or the nonpayment of taxes previously determined or proposed to be determined. Additionally, no criminal action will be brought against the taxpayer for the reporting periods for which amnesty is requested in cases of nonreporting or underreporting, unless the taxpayer is on notice of a criminal investigation or a court proceeding has already been initiated as of the first day of the amnesty period.

No refund or credit will be granted of any penalty paid prior to the time the taxpayer makes a request for amnesty.

After completion of the amnesty period, if the Board issues a deficiency determination upon a return filed under the amnesty program or upon any other

nonreporting or underreporting of tax liability by a person who could have otherwise been eligible for amnesty, the taxpayer will be assessed penalties at a rate that is double the rate of penalties normally applicable. Also, any deficiency determination issued under the above circumstance may be issued within 10 years from the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

In addition to the penalties provided above, any taxpayer who could have applied for amnesty but fails to do so, will be subject to a penalty of 50 percent of the accrued interest for the period beginning on the date the tax was due and ending on the last day of the amnesty period.

This bill requires that the Board adequately publicize the amnesty program so as to maximize awareness of the program.

BACKGROUND

In 1984, AB 3230 (Hannigan et al.), Chapter 1490, Statutes of 1984, imposed the state's only tax amnesty program. The amnesty program waived penalties and criminal sanctions for taxpayers who had not properly complied with reporting and payment requirements under the Sales and Use Tax Law and the Personal Income Tax Law but who came forward during the amnesty period to file proper returns and make proper payments (including accumulated interest). The 1984 tax amnesty program was enacted as a "one-time-only" program that was linked to law changes which strengthened both this Board's and the Franchise Tax Board's enforcement tools and penalties immediately after the amnesty program's expiration. This 94-day amnesty program began December 10, 1984 and ended March 15, 1985.

COMMENTS

- 1. Purpose.** This budget trailer bill was introduced in response to the state's budget deficit with an amnesty program designed to generate a rapid cash flow for fiscal year 2005-06.
- 2. Taxpayer benefits.** The amnesty program affords a solution to taxpayers who have been concerned about the liabilities built up by mistakes in reporting over the years. The taxpayer will still be required to pay the tax and interest, but penalties will be waived under the amnesty provisions.
- 3. Additional penalties.** In addition to the relief of penalties provided above, further incentive to convince taxpayers to participate in the amnesty program will be in the form of increased penalties for taxpayers who fail to participate in the amnesty program. These penalties include a penalty of 50 percent of the interest normally due until the end of the amnesty period and penalties imposed at double the normal rate. The state would also be given additional time to locate taxpayers who fail to participate in amnesty by extending the statute of limitations to 10 years for any period that could have been covered by amnesty.
- 4. Related Legislation.** These same provisions are contained in Assembly Bill 2114 (Assembly Budget Committee), which was held in the Senate.

Senate Bill 1881 (Senate Revenue and Taxation Committee) Chapter 527

Extended Due Date for Use Tax

Tax Payment Extension Due to Delayed State Budget

Fuel Prepayment Calculation

Renumber Duplicate Section Number

Effective January 1, 2005. Among its provisions, amends Sections 6459 and 6480.1 of, amends and renumbers Section 6480.3 of, and repeals Section 6451.5 of, the Revenue and Taxation Code

BILL SUMMARY

This bill contains **Board of Equalization-sponsored provisions** for the sales and use tax which do the following:

- Amend Section 6480.1 to include the new Sections 6051.5 and 7203.1 in the computation of the sales tax prepayment on fuels.
- Renumber Section 6480.3 of the Revenue and Taxation Code as Section 6480.9 due to duplicate section numbers within the Revenue and Taxation Code.

Additionally, this bill also contains provisions **sponsored by Board Member John Chiang** that allow for the tax payment extensions due to a delayed budget to be effective until the last day of the month following the month in which the budget is adopted (§ 6459) and repeals provisions that extend the due date for reporting and remitting use tax until April 15th of each year so that taxpayers reporting use tax due to prompts on the income tax return will be deemed to have filed timely (§ 6451.5).

Sponsor: Board of Equalization (*Sections 6480.1 and 6480.9*)
Board Member John Chiang (*Sections 6459 and 6451.5*)

Extended Due Date for Use Tax

Revenue and Taxation Code Section 6451.5

LAW PRIOR TO AMENDMENT

On June 25, 2003, the Board voted to adopt a joint effort between the Board and the Franchise Tax Board (FTB) to include a check-box line on the personal income tax return asking if the taxpayer has made any purchases from outside this state without payment of tax. Taxpayers answering "yes" would be directed to file a separate use tax return. Since any person who reports use tax from the previous calendar year to the Board in April based on instructions on the income tax form would have been

subject to interest and penalties since use tax would normally be due and payable to the Board on the last day of the month following the quarterly period in which the liability arose, the Board sponsored Senate Bill 1060 (Ch. 605, Stats. 2003) to add Section 6451.5 which allows an extended period of time for taxpayers to file use tax liabilities based on instructions on the income tax return.

However, similar provisions were also contained in Senate Bill 1009 (Ch. 718, Stats. 2003). These provisions authorized a person to report qualified use tax on their California income tax return for purchases made on or after January 1, 2003, and through December 31, 2009. SB 1009 also contained provisions that use tax reported on the income tax return is deemed to be filed timely provided the income tax return is filed timely. The FTB would transfer the use tax revenues received to the Board.

Due to the successful passage of SB 1009, the joint effort adopted between the Board and the FTB to include a check-box line on the personal income tax return was deemed redundant and was not implemented. Additionally, SB 1060 contained double-joining language that provided if SB 1009 passed, Section 6451.5 would not become operative. However, due to amendments to SB 1060 on September 2, 2003, the reference to the section of the bill that was not to become operative if SB 1009 were to pass was incorrectly listed as Section 6459 rather than 6451.5. As a result, Section 6451.5 became law with the successful passage of SB 1060, even though SB 1009 also successfully passed and became law.

AMENDMENT

This bill repeals Section 6451.5.

COMMENT

Since the Board is not going forward with the joint effort with the FTB to include a check-box line on the personal income tax return and SB 1009 already added provisions regarding the extended due date for use tax reported on the income tax return, Section 6451.5 is not needed.

<p>Tax Payment Extension Due to Delayed State Budget <i>Revenue and Taxation Code Section 6459</i></p>

LAW PRIOR TO AMENDMENT

Current law requires taxpayers to file sales and use tax returns on or before the last day of the month following the end of the reporting period. Failure to file the return timely and pay the taxes due would result in the imposition of penalties and interest.

Due to the delay in approving the state budget in 1992, the Board-sponsored Assembly Bill 101 (Stats. 1993, Ch. 324) to amend Section 6459 of the Revenue and Taxation Code to allow the Board to extend the time period in which a taxpayer must file a sales and use tax return when the taxpayer is an unpaid creditor of the state and a state budget has not been adopted in a timely manner. As amended, Section 6459 provides that the return is due at the end of the same month in which

the budget is adopted or one month from the due date of the return or payment, whichever comes later. Any taxpayer granted an extension is still required to pay interest on the amount of tax due to the state that exceeds the amount due from the state for the period from when the tax would have been due until the date paid to the state. Prior to passage of this bill, many taxpayers were unfairly burdened by the fact that they owed the state an amount of tax, while at the same time they were owed money by the state that they were unable to collect due to delays in enacting the state budget.

AMENDMENT

This bill amends Section 6459 to provide that the return is due at the end of the *following* month in which the budget is adopted or one month from the due date of the return or payment, whichever comes later, provided the taxpayer is a creditor of the state.

COMMENT

Purpose. Current law may not grant the taxpayer the necessary relief that the statute was intended to provide. The following scenarios illustrate the reason for the suggested change.

Scenario #1: Budget adopted August 30th

Period	Due Date	Last Day for Extension	Days from Budget to Extension Deadline
July Prepayment	August 24	September 24	24
July Return	August 31	September 30	30

Scenario #2: Budget adopted September 25th

Period	Due Date	Last Day for Extension	Days from Budget to Extension Deadline
July Prepayment	August 24	September 30	5
July Return	August 31	September 30	5

In Scenario #1, it is likely that the state will have paid its debts by the time the extension expires and the taxpayer is required to remit taxes due to the state, thus not imposing any financial hardship on the taxpayer. In Scenario #2, it is highly unlikely that the state will pay its debts to the taxpayer before the extension expires. This situation essentially defeats the purpose of the extension which is to allow the taxpayer to postpone payment of their tax liability until they are paid for overdue debts of the state.

The provisions in this bill will address the situation illustrated in Scenario #2. Under the provisions of this bill, the taxpayer in Scenario #2 would receive payment from the state prior to the due date of their tax liability since the extension would be good until October 31, rather than September 30.

These same provisions were contained in Board-sponsored Senate Bill 1060 (Ch. 605, Stats. 2003). However, due to a drafting error in amendments taken on September 2, 2003, this provision was incorrectly double joined with Senate Bill 1009. Due to this error and the successful passage of SB 1009, the amendments to Section 6459 did not become operative (Section 6451.5 should not have become operative).

Fuel Prepayment Calculation

Revenue and Taxation Code Section 6480.1

LAW PRIOR TO AMENDMENT

Under existing law, Section 6480.1 of the Sales and Use Tax Law requires suppliers and wholesalers of motor vehicle fuel (gasoline), aircraft jet fuel, and diesel fuel to collect a prepayment of the sales tax when they remove the fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after removal from the terminal rack. Section 6480.1 requires the Board to establish the sales tax prepayment rates on these fuels. The rate of prepayment is based upon 80 percent of the combined state and local sales tax rate established by Sections 6051, 6051.2, 6051.3, 7202, and Section 35 of Article XIII of the California Constitution on the arithmetic average selling price as determined by industry publications. The Board is required, by November 1, of each year to establish the new prepayment rates for these fuels. The new rates take effect each April 1 and remains in effect through each March 31.

Due to the successful passage of Proposition 57 in the March 2004 primary election, operative July 1, 2004, the state sales and use tax rate will increase by 0.25 percent and the local sales and use tax rate will decrease by 0.25 percent. Proposition 57 added Section 6051.5 of the Revenue and Taxation Code, to impose the new 0.25 percent state sales and use tax. The revenues generated from this tax are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds. Proposition 57 also added Section 7203.1 of the Revenue and Taxation Code, to provide that the tax rate percent imposed under Section 7202 is temporarily suspended, and the new tax rate to be applied instead is 1 percent for a county and 0.75 percent for a city (a 0.25 percent decrease).

AMENDMENT

This bill amends Section 6480.1 to include the new Sections 6051.5 and 7203.1 in the computation of the sales tax prepayment on fuels.

COMMENT

The purpose of this bill is to make a technical amendment to Section 6480.1 to base the prepaid sales tax on the combined state and local sales tax rates. The references to Sections 6051.5 and 7203.1 bring the base at which the prepaid sales tax is computed in line with the combined state and local tax rate.

<p>Renumber Duplicate Section Number <i>Revenue and Taxation Code Section 6480.9</i></p>

LAW PRIOR TO AMENDMENT

Section 6480.3 of the Revenue and Taxation Code was added in 1986 to address prepayment of sales tax on sales of motor vehicle fuel. In 2001, Section 6480.3 was amended by Assembly Bill 309 (Ch. 429, Stats. 2001) to include new terminology. However, due to an oversight, passage of Senate Bill 1901 (Ch. 446, Stats. 2002) added an additional Section 6480.3 authorizing a qualified person to issue an exemption certificate to a diesel fuel supplier with respect to that portion of diesel fuel that the qualified person reasonably expects to sell to farmers and food processors that qualify for the state sales and use tax exemption, under specified conditions. Both statutes in the code are currently listed as 6480.3.

AMENDMENT

This bill amends Section 6408.3, as added by Chapter 446 of the Statutes of 2002, to renumber the Section as 6480.9.

COMMENT

Purpose. The purpose of this bill is make a technical correction to the Revenue and Taxation Code due to duplicate Section numbers.

Senate Constitutional Amendment 4 (Torlakson) Resolution Chapter 133***Local Government Revenues- Triple Flip***

Effective upon approval of the voters at the November 2, 2004 General Election. Among its provisions, adds Section 25.5 to Article XIII of the California Constitution.

BILL SUMMARY

This constitutional amendment (appears as Proposition 1A on the November 2, 2004 General Election ballot) protects local government revenues. Among other things, this measure does the following:

- Prohibits the Legislature from restricting the authority of a city or county to impose a tax rate under the Bradley-Burns local sales and use tax law and the transactions and use tax law, as that law read on November 3, 2004;
- Prohibits the Legislature from changing the method of allocating local sales tax revenues under the Bradley-Burns local sales and use tax law and the transactions and use tax law, as that law read on November 3, 2004;
- Allows the Legislature to change the method of allocating local use tax revenues pursuant to Bradley-Burns local sales and use tax law in order to participate in an interstate compact or to comply with federal law; and,
- Prohibits the Legislature from extending the revenue exchange period (also known as the “Triple Flip”).

Although this bill affects property tax, sales and use tax, and vehicle license fee revenues, this analysis discusses the sales and use tax provisions only. The property tax and vehicle license fee provisions are not discussed because they are not within the scope of administration by the Board.

Sponsor: Senator Tom Torlakson

LAW PRIOR TO AMENDMENT

The **Sales and Use Tax Law** (Part 1, Division 2 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

Currently, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion.

However, during the revenue exchange period (operative July 1, 2004), the state tax rate increased by 0.25 percent, from 6 to 6.25 percent, and the local tax rate decreased by 0.25 percent, from 1.25 to 1 percent. The revenues from the 0.25 percent state tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the \$15 billion Economic Recovery deficit bonds.

The **Bradley-Burns Uniform Local Sales and Use Tax Law** (Part 1.5, Division 2 of the Revenue and Taxation Code), authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city to impose a local sales and use tax rate of 1 percent that is credited against the county rate. As previously stated, beginning July 1, 2004, existing law reduces by 0.25 percent the rate that may be imposed by a county from 1.25 to 1 percent, and by a city from 1 to 0.75 percent or less. Existing law also provides that the local tax rate will be increased by 0.25 percent when the Department of Finance (DOF) has made a specified notification to the Board, pursuant to Section 99006 of the Government Code, that the \$15 billion deficit-financing bond has been repaid.

The Board currently allocates the local sales tax to cities and counties primarily based on the retailer's place of business. The Board collects local taxes primarily from remittances by retailers, and relies on retailers to segregate taxable sales by location in order to determine the correct local sales tax allocation.

The **Transactions and Use Tax Law** (Parts 1.6 and 1.7, Division 2 of the Revenue and Taxation Code), authorizes a city or county to impose a transactions and use tax at a rate of 0.25 percent, or multiple thereof, for general or special purposes. Counties are authorized to impose a transactions and use tax for library programs at a rate of 0.125 or 0.25 percent. Certain cities and counties, through special enabling legislation, impose a rate other than multiples of 0.25 percent (e.g., the City of Clovis imposes a tax at a rate of 0.30 percent).

The transactions and use taxes are additional sales and use taxes imposed on the sale or use of tangible personal property. The maximum combined rate of transactions and use taxes levied in any county may not exceed 2 percent. City imposed transactions and use taxes count against the 2 percent cap so that the combined rate of transactions and use taxes imposed countywide may not exceed 2 percent.

AMENDMENT

This bill places a constitutional amendment to protect local government revenues before the voters at the November 2, 2004 General Election (Proposition 1A – Local Government Finance and Constitutional Amendment). Among its provisions, this bill would add Section 25.5 of Article XIII to the California Constitution, to prohibit the Legislature from doing any of the following:

- Restrict the authority of a city or county to impose a tax rate, or change the method of distributing revenues under the Bradley-Burns Uniform Local Sales and Use Tax Law, as that law read on November 3, 2004.

- Restrict the authority of a city or county to impose a tax rate, or change the method of distributing revenues under the Transactions and Use Tax Law, as that law read on November 3, 2004.
- Extend the revenue exchange period (also know as the “Triple Flip” period) or fail to restore the 0.25 percent reduction in the local sales and use tax rate after the revenue exchange period has ended. Also, prohibits the Legislature from reducing the payments of property tax revenues related to the temporary reduction in the local sales and use tax rate (during the revenue exchange period, cities and counties are reimbursed for their local sales and use tax revenue losses with property tax revenues).

Additionally, this measure allows the Legislature to authorize two or more specifically identified local agencies within any county, subject to majority voter approval of the governing bodies of each agency, to exchange allocations of property tax revenues for Bradley-Burns local sales and use tax revenues.

This measure would supersede Proposition 65 (also on the November 2, 2004 General Election ballot as Local Government Funds and Revenues, State Mandates, Initiative Constitutional Amendment), if both measures are approved and this measure receives a higher number of affirmative votes.

BACKGROUND

Several bills have been introduced over the years that would have changed the method of allocating the Bradley-Burns local sales tax revenues. Some of the more recent bills are:

- **AB 2466 (Yee, as amended August 23, 2004)** would have changed the method of allocating the local sales tax on sales of jet fuel delivered into aircraft by both in-state and out-of-state retailers with only one place of business in California. The Governor vetoed this bill on September 30, 2004. In part, the veto message states, “. . . The policy issue contained in this bill, while important, does not require waving an opportunity for the public to be involved in the process.”
- **AB 553 (Chavez, 2003-04)** would have changed the allocation method on sales of concrete by a concrete batch plant. Specifically, this bill would have provided that the retail sale of concrete occurs at the concrete batch plant from which delivery is made to the end-use customer if both of the following conditions are met: (1) the principal negotiations for the sale are conducted in California, and (2) the retailer has more than one place of business in California. This bill was held in Assembly Appropriations Committee.
- **SB 1114 (Brulte, 2001-02)** would have changed the allocation method on sales of concrete by a concrete batch plant. The provisions of this bill were identical to AB 553 of the 2003-04 Legislative Session. This bill was held in Assembly Appropriations Committee.
- **AB 680 (Steinberg, 2002-03)** would have changed the allocation method of the local sales tax in El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties. Specifically, this bill would have required the Board to segregate the 1 percent local sales tax revenues generated within the greater Sacramento region

into a separate account. The Board would then allocate those revenues to the cities and counties in the greater Sacramento region as specified. This bill was never heard in the Senate Local Government Committee.

- **SB 1982 (Alpert, 1999-2000) and SB 2000 (Polanco, 1999-2000)** would have changed the method of allocating local sales and use tax revenues from the current situs-only basis (i.e., place of sale) to combinations of situs and population bases for each county and all cities within the county. The Legislature created a conference committee centered on another local government bill, to address issues related to local government finance in one comprehensive package. The authors stripped the original language in SB 1982 and SB 2000 in order to be a part of those discussions.

COMMENTS

1. **Purpose.** This bill is part of the Governor's 2004-05 Budget which proposes shifting \$1.3 billion in property tax revenues from local governments to schools in exchange for constitutionally protecting local governments' revenues in the future.
2. **This bill prohibits the Legislature from reducing the local sales and use tax rates.** This bill prohibits the Legislature from enacting a statute that would reduce the Bradley-Burns sales and use tax rate or the Transactions and Use Tax rate. As previously stated, the Bradley-Burns local tax law authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city, located within a county imposing such a tax rate, to impose a local sales tax rate of 1 percent or less that is credited against the county rate. Beginning on July 1, 2004, and continuing through the revenue exchange period (also known as the "Triple Flip"), existing law temporarily suspends the authority of a city or a county to impose a sales and use tax rate under the Bradley-Burns law and provides that the new rate to be applied instead is 1 percent for a county and 0.75 percent or less for a city. Under the Transactions and Use Tax Law, cities and counties are authorized to impose transactions and use taxes at various rates for various purposes.

This bill prohibits the Legislature from reducing any tax rates imposed under Bradley-Burns Uniform Sales and Use Tax Law or Transactions and Use Tax Law, as those laws read on November 3, 2004.

3. **This bill prohibits the Legislature from changing the method of allocating local sales tax revenues.** This bill prohibits the Legislature from changing the method of allocating local sales tax revenues under the Bradley-Burns Uniform Sales and Use Tax Law or the Transactions (sales) and Use Tax Law, as those laws read on November 3, 2004. This bill would freeze the place-of-sale orientation of the local tax system in place. The Legislature could, however, revise the allocation method of the use tax portion of the Bradley-Burns tax if necessary to allow the state to participate in an interstate compact or to comply with federal law.

Current law allocates the sales tax primarily based on the retailer's place of business. The following explains the current "place of sale" statutes for allocating local taxes under Bradley Burns and Transactions and Use Tax Law:

Bradley-Burns Tax Law – Place of sale

In general, under the Bradley-Burns law, all retail sales in California are consummated at the place of business of the retailer. If a retailer has only one place of business in California, the local sales tax derived from sales consummated at the place of business are allocated to the city, county, or city and county in which the retailer's place of business is located. If a retailer has more than one place of business in California, the sale occurs at the place of business where the principal negotiations are carried on. Accordingly, the local sales tax is allocated to the city, county, or city and county where the business conducting the negotiations is located.

Bradley-Burns use tax is imposed on the purchase for storage, use, or other consumption in this state of tangible personal property purchased from a retailer. Since use tax is not identified with a specific registered place of business, the tax generally is allocated to the local jurisdictions in the county of use through a countywide pool. Examples of taxpayers who report use tax allocated through the countywide pool include construction contractors who are consumers of materials used in making improvements to real property and out-of-state sellers who ship merchandise directly to consumers in the state from a stock of goods located outside the state.

Effective January 1, 1999, Section 7205 was amended to add provisions related to the "place of sale" of jet fuel (AB 66, Chapter 1027, Statutes of 1998). The new section 7205(b)(2) provides that if the following conditions are met: (1) the principal negotiations for the sale are conducted in this state, and (2) the retailer has more than one place of business in the state, then the place of sale is deemed to be the point of delivery of that jet fuel to the aircraft. Under these conditions, the local tax is allocated to the local jurisdiction in which the jet fuel is delivered into the aircraft.

Transactions and Use Tax Law – Place of sale

For purposes of allocating transactions and use tax, the tax generally follows the merchandise. That is, the tax is allocated to the special taxing jurisdiction (district) where the goods are delivered (and presumably used.)

For retailers with one location, whose business location is in a district, must generally report transactions tax on their sales unless: (1) the retailer, the retailer's agent, or a common carrier ships or delivers the merchandise to an out-of-state or out-of-district location; or (2) the sale is exempt from the general sales tax. If a retailer's business is located outside a district, the retailer's sales are not subject to transactions tax. However, the retailer may be liable for district use tax if he or she is "engaged in business" in a district.

A retailer is "engaged in business" in a district if the retailer does any of the following:

- Maintains, occupies, or uses any type of office, sales room, warehouse or other place of business in the district, even if it is used temporarily, indirectly or through an agent;
- Has any kind of representative operating in the district for the purposes of making sales or deliveries, installing or assembling tangible personal property, or taking orders;
- Derives rentals from a lease of tangible personal property located in the district;
- Sells or leases of vehicles, undocumented vessels, or aircraft which will be registered in a district.

For retailers with multiple locations, the place of sale is generally considered the location at which the retailer conducts its principle negotiations even if an order is forwarded to another location for acceptance, approval of credit, shipment, or billing. As with a single location business, retailers with multiple locations are allowed an exemption from district tax for merchandise which is shipped to an out-of-state location or for merchandise which is exempt from the general sales tax. Also, multiple outlet retailers are not liable for transactions tax on sales made at business locations outside districts. However, retailers may be liable for collecting district use tax on merchandise shipped into a district for which the retailer is “engaged in business.”

- 4. Provides additional protection to cities and counties on provisions related to the Triple Flip.** This bill prohibits the Legislature from enacting a statute that would extend the period of the Triple Flip or reduce the property tax payments to cities and counties required under the Triple Flip. Existing law reduces the local sales and use tax rate by 0.25 percent and increases the state sales and use tax rate by the same amount until the \$15 billion Economic Recovery Bonds have been paid off. During this “Triple Flip” period, cities and counties are reimbursed for their local sales and use tax revenue losses with property tax revenues. This bill prohibits the Legislature from extending the revenue exchange period (also known as the Triple Flip) or failing to restore the 0.25 percent local sales and use tax rate when the revenue exchange period ends. This bill also prohibits the Legislature from reducing the payments of property tax revenues to cities and counties during the Triple Flip.

TABLE OF SECTIONS AFFECTED

SECTIONS		BILL AND CHAPTER NUMBER		SUBJECT
Revenue & Taxation Code				
§6248	Amend Repeal Add	SB 1100	Ch. 226	Presumption of purchase for use: vehicles, vessels and aircraft
§6451.5	Repeal	SB 1881	Ch. 527	Qualified use tax due date
§6459	Amend	SB 1881	Ch. 527	Tax payment extensions due to delayed budget
§6480.1	Amend	SB 1881	Ch. 527	Fuel prepayment calculation
§6480.3	Amend and renumber	SB 1881	Ch. 527	Prepayment exemption: diesel fuel sold for agricultural purposes
§6592	Amend	SB 1100	Ch. 226	Tax amnesty
§7057	Repeal	AB 3071	Ch. 353	Registration of employers
Article 2 (commencing with §7070) of Ch. 8 of Part 1 of Division 2	Add	SB 1100	Ch. 226	Tax amnesty
§7099.1	Amend	AB 1416	Ch. 412	Tax practitioner – client confidentiality
§7203.1	Amend	AB 2115	Ch. 610	Revenue exchange period: rate of tax
§7203.1	Amend	SB 1096	Ch. 211	Revenue exchange period: rate of tax
Government Code				
§11093	Amend	AB 2207	Ch. 181	Statistical data – San Fernando Valley
Health and Safety Code				
§40608	Add	AB 2585	Ch. 885	Kings County – Sales tax and use tax revenues

TABLE OF SECTIONS AFFECTED CONTINUED

SECTIONS		BILL AND CHAPTER NUMBER		SUBJECT
Unemployment Insurance Code				
§329	Amend	AB 3020	Ch. 685	Joint Enforcement Strike Force on the underground economy
California Constitution				
§25.5 of Article XIII	Add	SCA 4	Resolution Chapter 133	Bradley-Burns local sales and use tax and Transactions and use tax