California State Board of Equalization,
Legislative and Research Division

LEGISLATIVE BULLETIN

State Capitol Building (from the East) c.1945
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SALES TAX LEGISLATION
2006

SALES TAX LEGISLATION
TABLE OF CONTENTS

CHAPTERED LEGISLATION ANALYSES **PAGE**

Assembly Bill 588 (Goldberg and Koretz) Chapter 185

Statistical Data - Hollywood

Effective January 1, 2007. Adds Section 11093.4 to the Government Code.

BILL SUMMARY

This bill requires the State Board of Equalization (Board), Employment Development Department (EDD), Department of Industrial Relations (DIR), Department of Finance (DOF), and the Department of Transportation (DOT), in the preparation and maintenance of any statistical analyses and data by city, to make a separate breakdown of the community of Hollywood, as provided, and require the City of Los Angeles to provide all necessary data.

Sponsor: Hollywood Chamber of Commerce

LAW PRIOR TO AMENDMENT

Since 1976, pursuant to Section 11093 of the Government Code, the Department of Finance, the State Department of Health Services, and the Department of Transportation have been required, in the preparation and maintenance of any statistical analyses of cities, to make a separate breakdown of the San Fernando Valley. The City of Los Angeles is required to provide all necessary data. However, other state agencies were not required to prepare or maintain any statistical information by city unless: (1) information was currently being prepared or maintained by city; or (2) a state agency voluntarily prepared or maintained information by city.

Effective January 1, 2005, the passage of Assembly Bill 2207 (Chapter 181, Statutes 2004) requires any state agency or department that develops and maintains data and statistics on the municipal level to make a separate breakdown of the San Fernando Valley in the preparation and maintenance of any statistical analyses by city, and authorizes state agencies to require the City of Los Angeles to provide all necessary data. If the use of a tax area code is required in order to make a separate breakdown of the San Fernando Valley, then an alternate method may be used to determine the separate breakdown of the San Fernando Valley. Also under current law, the Controller may, upon request in a motion adopted by the City Council of the City of Los Angeles, designate additional statistical areas within the City of Los Angeles, except that the statistical areas shall not exceed three in number.

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 both a quarterly and annual booklet titled “Taxable Sales in California (Sales & Use Tax).” The booklets are a quarterly or annual report on retail sales activity in California. These reports provide 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. Both the quarterly and annual reports are available on the Board’s website at www.boe.ca.gov.

AMENDMENT

This bill adds Section 11093.4 to the Government Code to provide that the Board, EDD, DIR, DOF, and DOT are required, in the preparation and maintenance of any statistical analyses and data by city, to make a separate breakdown of the community of Hollywood, and requires the City of Los Angeles, at its sole expense, to provide all necessary data. This bill also:

- Specifies that the designated state agencies are required to implement the bill only to the extent the data is available from federal, state or local sources that provide data for other jurisdictions or is provided by the City of Los Angeles, and that the state agencies are not required to develop or collect data;
- Prohibits data from being reported if such reporting would violate data confidentiality agreements or rules;
- Specifies that the designated state agencies are not required to report data that would not meet the statistical accuracy standards for the publication or data series for which they relate.
- Permits the designated state agencies to report special analyses or data compilations for the community of Hollywood if reimbursement or other funding is provided;
- Permits an alternate method to be used to determine the separate breakdown of the community of Hollywood if the use of a tax area code is required to comply with provisions of the bill; and
- Makes various legislative findings.

COMMENTS

1. **Purpose**. The purpose of this bill is to promote the development of reliable statistical information for the Hollywood area. The Hollywood area has turned a corner from the crime and dilapidation that plagued the area for decades and, today, is attracting close to $1 billion in new development. The Hollywood Chamber of Commerce now receives numerous requests each month for information on the community. Developers, entrepreneurs interested in opening

businesses, civic and education leaders as well as residents are requesting specific data on Hollywood's population, median income, employment, housing stock, general land use, tourism and infrastructure. However, the critical data and information is often scattered among multiple city agencies and departments, not reported on a regular basis, or is not collected at all. The difficulty or, sometimes, impossibility of gathering information in a timely manner often jeopardizes bringing major development and is a barrier to planning and to promoting Hollywood's economic and social growth.

2. **Key amendments.** The **June 13, 2006 amendments**: 1) narrowed the list of state agencies required to provide separate statistical reporting for the community of Hollywood; 2) required the City of Los Angeles to bear the full expense of providing the necessary data; 3) provided that the state agencies required to make a separate breakdown are to do so only to the extent that data is available from federal, state, or local sources or is provided by the City of Los Angeles, and that the state agencies are not required to develop or collect data; 4) specified that state agencies are not required to report data that would not meet the statistical accuracy standards for the publication or data series for which they relate; 5) provided that state agencies may report special analyses or data compilations for Hollywood if reimbursement or other funding is provided; and 6) made various legislative findings. The **June 30, 2005 amendments** required the Department of Housing and Community Development, Department of Real Estate, California Housing Finance Agency, Department of Motor Vehicles, Department of Transportation, Department of General Services, and the Department of Fair Employment and Housing, in addition to the Board, FTB, EDD, DIR, and the DOF, in preparing data and statistics by city, to make a separate breakdown of the community of Hollywood. The **June 21, 2005 amendments** required the Board, FTB, EDD, DIR, and the DOF, rather than all state agencies, in preparing data and statistics by city, to make a separate breakdown of the community of Hollywood. The **May 31, 2005** amendments made technical changes to the geographical description of the community of Hollywood. The **March 29, 2005 amendments** corrected street names that had been misspelled.

3. **To develop data using the Board's tax area code system would be costly.** As previously stated, the Board maintains two types of data by city and county: 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 as this bill allows, the Board would have to treat the community of Hollywood as a newly incorporated city. This would require creating a special tax area code for the community of Hollywood. Once the tax area code is established, the Board would have to identify all accounts within the community of Hollywood. The Board requires all newly incorporated cities to furnish maps and listings of street addresses. The Board would have to print out all accounts currently within the City of Los Angeles and the surrounding areas. 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 community of Hollywood.

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 establishing the new tax area for the community of Hollywood include: preparing written guidelines for audit and compliance staff; designing and printing a special mailer to be mailed with the tax returns to all affected accounts, and revising various forms and publications.

4. **"Alternate method" for the San Fernando Valley.** Prior to the enactment of Assembly Bill 2207, Board staff met with the author's staff to discuss how it prepared statistical data on cities. Board staff explained to the author's office that to use a tax area code to make a separate breakdown for the San Fernando Valley would be too costly. The author's staff recommended amending the bill to provide that, in the case where a tax area code is used in making a separate breakdown for the San Fernando Valley, an alternate method may be used instead. The Board staff explained that, if the City of Los Angeles were to compile data on the San Fernando Valley, 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. The Board staff explained that it would publish the data provided the City of Los Angeles in its "Taxable Sales in California (Sales and Use Tax)" publication.

   The taxable sales data on the San Fernando Valley will also contain a footnote referencing that the source of the data is the City of Los Angeles. A footnote regarding the source of the data is necessary because the Board will not be preparing the data.

5. **This bill presents the same concerns for the Board that the San Fernando Valley bill did.** As previously stated, to make a separate breakdown of the community of Hollywood using a tax area code would be too costly. In addition, to modify the Board's computer system in order to capture data using another method would be equally as costly.

   The problem with using an alternate method, with the City of Los Angeles providing all necessary data, is that it is data that is <u>not</u> prepared by the Board. The data is primarily prepared by the City of Los Angeles, with minimal verification performed by the Board. This data would be published in the Board's Taxable Sales in California publication; however, there would be a footnote stating that the data was developed from a source other than the Board. It seems that the purpose of the bill is to have reliable data developed for a specified statistical area, and to the extent feasible, to require state agencies already collecting data by city, to collect data for a new statistical area. The problem is that the Board's existing system cannot be reasonably modified to collect data using another method. This means that in order to keep the costs at a minimum, the City of Los Angeles will prepare the data for the community of Hollywood (like they are required to do for the San Fernando Valley), with minimal verification performed by the Board.

6. **Could taxable sales data be developed using zip codes?** Zip codes are developed for purposes of mail delivery and not geographical boundary determinations. In general, city boundaries and zip codes do not coincide. Some cities have multiple zip codes. For example, most of the City of Diamond Bar is in the 91765 zip code, but the City's western area is in the 91789 zip code, centered on the adjacent City of Walnut. Some zip codes encompass parts of a city and the unincorporated area of a county. For example, the City of Trinidad and parts of Humboldt County have the same zip code. Therefore, to develop data using zip codes can result in the data being materially under- or over-stated.

   In addition, the Board can extract data using zip codes for a sales and use tax account that consists of a single selling location. However, the Board's system cannot extract data using zip codes for consolidated accounts, which is a sales and use tax account consisting of two or more selling locations for which a single tax return is filed. The Board's local sales and use tax schedules for consolidated accounts are based on tax area codes, not zip codes. An example of a consolidated account would be a large drug store, which could have 15 stores reported on one consolidated return. The data on the individual stores would be reported based on tax area codes. Additionally, if two or more stores are in the same tax area code, the retailer may report a combined amount of tax for that tax area code, thus making it impossible to identify an amount attributable to the individual location. Therefore, to develop data using zip codes that would not capture the sublocations on consolidated accounts would result in very imprecise data almost to the point of being meaningless.

7. **Is legislation necessary?** Under current law, the Controller may, upon request in a motion adopted by the City Council of the City of Los Angeles, designate additional statistical areas within the City of Los Angeles, except that the additional statistical areas shall not exceed three in number. Perhaps the author should first attempt making a request to the City of Los Angeles and the Controller before pursuing legislation.

8. **Related Legislation.** Assembly Bill 2329 (Oropeza) would have required the Franchise Tax Board, EDD, DOF, DIR, DOT, Department of Housing and Community Development, Department of Real Estate, California Housing Finance Agency, Department of Motor Vehicles, Department of General Services, and the Department of Fair Employment and Housing, in the

preparation and maintenance of any statistical analyses and data by city, to make a separate breakdown of the South Bay Cities and Harbor area within the County of Los Angeles. This bill was set to be heard in Assembly Business and Professions Committee, but the hearing was canceled at the request of the author.

Senate Bill 143 (Runner, Ch. 679, Stats. 2005) requires the EDD and DOF, in the preparation and maintenance of statistical analyses and data by county, to make a separate breakdown of the Antelope Valley, as specified, and encourages the Counties of Kern and Los Angeles to voluntarily provide data to those state agencies.

Assembly Bill 1418 (J. Horton) Chapter 716

Publication of Top 250 Delinquencies

Effective January 1, 2007. Adds Article 1.5 (commencing with Section 7063) to Chapter 8 of Part 1 of Division 2 of the Revenue and Taxation Code.

BILL SUMMARY

This bill requires the Board, after providing a 30-day advance written notification to taxpayers, to make available as a matter of public record, a quarterly list of the top 250 delinquent sales and use taxpayers in excess of $100,000, as specified. The bill contains similar provisions for tax delinquents falling under the purview of the Franchise Tax Board.

Sponsor: Assembly Member Jerome Horton

LAW PRIOR TO AMENDMENT

Under existing law, Section 7056 of the Sales and Use Tax Law prohibits the Board to make known in any manner whatever, the business affairs, operations, or any other information pertaining to any retailer or any other person required to report to the Board or pay a sales and use tax. However, some exceptions exist in current law where confidential tax information is released to the public. For example, an exception exists under the settlement provisions of Section 7093.5 where the Board settles tax matters in dispute that are the subject of protests, appeals or refund claims. The law requires that a public record be made with respect to a settlement whenever a reduction in tax in excess of $500 is approved. The public record must include, among other things, the name of the taxpayer, the total amount in dispute, and the amount agreed to pursuant to the settlement. Another exception includes cases where a taxpayer is delinquent in his or her tax obligations and the Board files a lien. The recording of the tax lien pursuant to Section 6757 establishes a public record of the existence of the lien against all property belonging to the taxpayer and located in this state.

AMENDMENT

This bill adds Article 1.5 (commencing with Section 7063) to Chapter 8 of the Sales and Use Tax Law to require the Board to make available as a matter of public record each quarter, a list of the 250 largest sales and use tax delinquencies in excess of $100,000. A delinquency is described in the bill as an amount of tax that has been either determined by the Board or self assessed by the taxpayer and that is delinquent for more than 90 days for which a state tax lien has been filed, but will not include:

- Any delinquency that is under litigation in a court of law;
- Any delinquency for which suitable payment arrangements have been made with the Board; or
- Any delinquency for which the taxpayer has filed bankruptcy.

Prior to making a tax delinquency a matter of public record, however, the bill requires the Board to provide a preliminary written notice by certified mail, return receipt requested, to the person or persons held liable for the tax. If within 30 days of issuance of that written notice, the person or persons do not either remit the amount due, or otherwise make arrangements with the Board for payment of the amount due, the tax delinquency is required to be included on the list.

The bill specifies that the quarterly list include:

- The telephone number and address of the Board office to contact if a person believes placement of his or her name on the list is in error.
- The aggregate number of persons that have appeared on the list who have satisfied their delinquencies in their entirety and the dollar amounts, in the aggregate, that have been paid attributable to those delinquencies.

The bill requires the Board to remove any delinquencies from the list, as promptly as feasible, but no later than five business days, if any of the following occur:

- The person liable for the tax has contacted the Board and resolution of the delinquency is or has been arranged.
- The Board has verified that an active bankruptcy proceeding has been initiated.
- The Board has verified that a bankruptcy proceeding has been completed and there are no assets available with which to pay the delinquent amount.
- The Board has determined that the delinquency is uncollectible.

The bill further specifies that any person whose delinquency appears on the quarterly list, and who satisfies that delinquency in whole, or in part, may request the Board to include in its quarterly list any payments the person made to satisfy the delinquency. Upon receipt of that request, the bill specifies that the Board shall include those payments on the list as promptly as feasible.

The bill also provides that a person whose delinquency appeared on the list and whose name has been removed because the person contacted the Board and arranged for resolution of the delinquency the person shall be placed back on the list without preliminary notice if he or she fails to comply with the terms of the arranged resolution.

BACKGROUND

From January 1, 2000 to January 1, 2005, similar provisions were in the Sales and Use Tax Law, as added by AB 790 (Honda, Stats. 1999, Ch. 443), except that bill limited the list to the top 12 delinquent taxpayers in excess of one million dollars. The Board sponsored that measure in an effort to induce taxpayers to clear their accounts with the Board. At that time, those 12 delinquent taxpayers owed the Board over $52 million. However, the Board only collected from one account that appeared on the list, and the collection of that delinquent account was not attributable to the posting of the delinquency on the Internet. Instead, the collected amount (totaling $1.7 million) was a result of the Board's other enforcement efforts.

Because the statute at that time was so limiting, it did not create an avenue to significantly reduce the past due delinquencies. Also, most of the taxpayers' businesses had been closed.

COMMENTS

1. **Purpose.** The purpose of this bill is to serve as an inducement for delinquent sales and use taxpayers to clear their accounts with the Board and to reduce the Board's accounts receivables.

2. **Key amendments.** The **August 10, 2006 amendments** incorporated various clarifying changes, including an amendment to specify that a person whose delinquency appeared on the list and whose name has been removed because the person contacted the Board and arranged for resolution of the delinquency, shall be placed back on the list without preliminary notice if he or she fails to comply with the terms of the arranged resolution. The **August 7, 2006 amendments** deleted the requirement that a return receipt was required for the preliminary notice to the persons liable for the tax. Instead, the amendments specify that the preliminary notice shall be provided to the persons by certified mail, return receipt requested, and that if, within 30 days of the issuance of the notice, the person does not remit the amount due, or make arrangements for payment of the amount due, the tax delinquency shall be included on the list. The **January 23, 2006 amendments** made changes to the FTB-related provisions. The **January 4, 2006 amendments** incorporated the Board's suggested amendments. These amendments incorporated provisions to include within the group of taxpayers that may be included on the list those taxpayers that have delinquencies of self-assessed taxes. Without this amendment, any taxpayers that collected tax reimbursement and filed returns with the Board without payment of the tax would not have been placed on the list.

   The amendments also eliminated the requirement that would have required that the person receive tax or tax reimbursement in order to be placed on the list. This would have excluded any taxpayers that were found to be liable for use tax due, or those that had failed to properly report their taxable sales.

3. **Delinquent taxes are already a matter of public record.** Proponents note that these lists aren't violating privacy laws because tax delinquencies are already a matter of public record, through the filing of tax liens in the county recorder's offices.

4. **Public disclosure of tax delinquencies is gaining interest**. The state of Connecticut was the first state to begin a public listing of delinquent taxpayers. Its program began in January 1997. Since then, at least 12 other states began publicly disclosing the names of their top tax delinquents. These states include Georgia, Maryland, Colorado, Rhode Island, Washington, Indiana, Louisiana, North Carolina, South Carolina, Minnesota, New Jersey and Pennsylvania.

<u>Assembly Bill 1809 (Committee on Budget) Chapter 49</u>

Vehicles, Vessels and Aircraft

Allocation of Sales and Use Tax Administrative Costs

Tax Expenditure Reports

Urgency measure, effective June 30, 2006, but operative July 1, 2006. Among its provisions, amends Sections 6248, 7204.3, and 7273 of the Revenue and Taxation Code and amends, repeals, and adds Section 13305 of the Government Code.

BILL SUMMARY

This Budget trailer bill makes a number of revenue and taxation related changes necessary to implement the Budget Act of 2006. This Budget trailer bill, among other things unrelated to the Board, does the following:

1. Extends for one year the sunset date (from July 1, 2006 until July 1, 2007) of the sales and use tax provision that specifies that 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 *(Rev. and Tax. Code, § 6248)*.
2. Beginning fiscal year 2006-07, and each fiscal year thereafter, requires the Board's administrative costs associated with administering the sales and use tax on behalf of the state and local jurisdictions to be based on the methodology described in the November 2004 report by the State Board of Equalization entitled "Response to the Supplemental Report of the 2004 Budget Act" (*Rev. and Tax. Code, §§ 7204.3 and 7273).*
3. Beginning January 1, 2007, requires the Department of Finance to provide a report to the Legislature by September 15th of each year on tax expenditures exceeding $5 million annually and specifies the additional information that the report must contain on each tax expenditure, including, but not limited to, the statutory authority and description of the legislative intent, and information on sales and use tax expenditures, as specified. *(Government Code, §13305)*.

Sponsor: Assembly Committee on Budget

Vehicles, Vessels and Aircraft
Revenue and Taxation Code Section 6248

LAW PRIOR TO AMENDMENT

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 undocumented vessel, to the Department of Motor Vehicles.

Under the law, 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, in another state or in a foreign country, using the retailer's own delivery vehicle or another means of transport that the retailer owns; or
- Ships the product to another state or to a foreign country by delivering it to a common carrier, contract carrier, customs broker, export packer, or forwarding agent.

Section 6248 of the Sales and Use Tax Law, as amended by SB 1100 (Stats. 2004, Ch. 226), provides that, for the period October 2, 2004, through and including June 30, 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.

This section 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. Such evidence includes, but is not limited to, proof of registration of that vehicle, vessel, or aircraft with the proper authority outside of this state. In addition, the law specifies that these 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, Section 6248 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.

AMENDMENT

This provision extends for one additional year, until and including June 30, 2007, the 12-month rebuttable presumption contained in Section 6248 related to purchases of vehicles, vessels and aircraft.

The provisions are effective June 30, 2006, but operative July 1, 2006.

BACKGROUND

The amendments to Section 6248 that occurred by Stats. 2004, Ch. 226 (SB 1100), were part of the tax-related provisions of the 2004-05 budget package. The amendments were prompted by a perceived tax loophole with respect to the law at that time. Then, under the law and Board regulations, a vehicle, vessel, or aircraft purchased outside this state by a California resident was presumed to have been purchased for use in California and subject to the California use tax if the item was brought into California within 90 days of purchase. Also, a vehicle, vessel, or aircraft purchased outside this state by a nonresident was presumed to have been purchased for use in California if it entered this state within the first 90 days of ownership. These transactions were subject to the use tax unless all of the following occurred:

- The purchaser took title to and possession of the vehicle, vessel, or aircraft while it was out of state; and
- The purchaser made the first functional use of it outside the state; and
- The purchaser used it out of state for more than 90 days before the vehicle, vessel, or aircraft first entered California.

Under these provisions, there were instances in which, for example, 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.

The 12-month provisions incorporated into Section 6248 were intended to reduce the frequency of these sorts of arrangements.

COMMENTS

1. **Purpose.** The purpose of this budget trailer bill was to extend the 12-month rebuttable presumption contained in Section 6248 to minimize the revenue losses associated with the 90-day rebuttable presumption provisions in prior law, thereby increasing the State's revenues.

2. **Why not extend the provisions indefinitely**. SB 1100 (Stats. 2004, Ch. 226) required the Legislative Analyst's Office (LAO) to examine the economic and fiscal impacts of the change to Section 6248. The LAO found that (1) the law change has resulted in a sharp reduction in out-of-state usage exemptions and an increase in sales and use tax revenues, and (2) the negative economic impacts arising from the measure do not appear to be particularly large. The LAO indicated that it would be preferable to permanently extend these provisions. The report states that the year-to-year extension of this tax law change would likely create behavioral incentives having negative consequences for both the industries involved and the state. The report points out that there is some evidence that the July 2006 sunset date is starting to encourage the postponement of purchases (as some prospective customers wait for the potential return of the 90-day test). This type of behavioral effect would likely continue if the expectation is that the one-year test will be in effect for just one additional year. The LAO believes that it would be preferable to settle the policy issues now and put in place a permanent set of standards so that buyers and sellers will know what the "ground rules" will be in the future.

Allocation of Sales and Use Tax Administrative Costs

Revenue and Taxation Code Sections 7204.3 and 7273

LAW PRIOR TO AMENDMENT

Under current law, the Board charges the State, local governments, and local jurisdictions a fee for administering the state and local sales and use taxes on their behalf. Under current law, Section 7204.3 of the Bradley-Burns Uniform Local Sales and Use Tax Law requires the Board to charge a city, city and county, county, or redevelopment agency (hereinafter referred to as Bradley-Burns), an amount for the Board's services in administering the local sales and use tax ordinance. Current Section 7273 of the Transactions and Use Tax Law requires the Board to charge an amount for its administration of the local transactions and use tax ordinance of each special taxing jurisdiction (STJ).

Under these statutes, the Board also is required to use a costing model for allocating its costs that is based on recommendations made in the March 1992 and January 1996 reports by the Office of the Auditor General (now the Bureau of State Audits). AB 102 (Ch. 75, Stats. 1993) amended Sections 7204.3 and 7273 to set the policy that controls the Board's current costing model and implemented the recommendations contained in the Auditor General's March 1992 report entitled "The Board of Equalization Needs To Adjust Its Model For Setting Reimbursement Rates For Special Tax Jurisdictions."

The 1996 Bureau of State Audits report titled "Board of Equalization: Policies and Cost Assessment Methods for Special Tax Jurisdictions Need Reconsideration," made additional recommendations regarding the costing model, as follows:

- State policy makers should examine whether STJs should bear a percentage of the infrastructure costs associated with administering sales taxes.
- The costing model should not charge STJs for the costs of administering the two statewide half-cent sales taxes.
- Workload factors that are based on workload studies should be used and periodically updated.
- Costs to individual STJs should be based on workload factors, rather than revenue.

In addition, AB 836 (Sweeney, Ch. 890, Stats. 1998) and SB 1302 (Senate Revenue and Taxation Committee, Ch. 865, Stats. 1999) required that the Board's administrative charges for STJs be capped at a percentage of revenue depending on the local jurisdiction's tax rate.

AMENDMENT

This bill amends Section 7204.3 to, beginning with the 2006-07 fiscal year, and each fiscal year thereafter, require the Board to charge a city, city and county, county, or redevelopment agency an amount for the Board's services in administering the sales and use tax ordinance of the local entity based on the methodology described in

Alternative 4C of the November 2004 report by the Board entitled "Response to the Supplemental Report of the 2004 Budget Act."

This bill also amends Section 7273 to, beginning with the 2006-07 fiscal year, and each fiscal year thereafter, require the Board to charge each STJ an amount for the Board's services in administering the sales and use tax ordinance of the STJ based on the methodology described in Alternative 4C of the same November 2004 report. With respect to allocating costs to each STJ, this bill:

- Provides that the amount charged each STJ be based on that STJ's proportional share of the revenue after weighting the revenue to equalize the differences in transactions and use tax rates; and,
- Eliminates the provisions that placed a limit on the amount (known as "The Cap") the Board could charge each STJ.

New costing methodology - Alternative 4C

This bill implements a new methodology known as Alternative 4C for allocating the Board's administrative costs among the State, Bradley Burns, and STJs. The following provides a brief description of how those costs are allocated under Alternative 4C.

As with the existing model, Alternative 4C begins with the four sales and use tax program elements as reflected in the approved Governor's Budget. Those elements are Registration, Returns, Audit, and Collections. Since central agency costs (i.e., costs incurred by the State's central service departments) are not reflected in the Governor's Budget, these costs are added based on the overall central agency percentage to each of the four elements.

Unlike the existing model, the new model makes no calculations to determine direct and shared costs. Rather, the new model applies a separate cost pattern to the cost of the Registration, Audit, and Collection elements based on a revenue pattern that represents the workload of that element.

- Registration cost is allocated on the revenue received through the normal returns process.
- Audit cost is allocated based on total tax change, including both over and under reporting of tax.
- Collections cost is allocated based on delinquent taxes billed by the Board's collection program including non-paid or underpaid taxes reported on returns filed and Board determinations for failure to file returns or additional taxes due in excess of reported amounts.

The Returns element is allocated using information from the sales and use tax return. A ratio is calculated based upon how many lines on the return are associated with the State, Bradley Burns, or STJs. Since some of the lines on the return relate to all three entities (subtotal lines or total lines), these generic lines are allocated based on total revenue.

IN GENERAL

The following provides a summary of the main steps in allocating the administrative costs, including a description of the STJ cap adjustment, before the enactment of this bill.

Existing Cost Model

There are two distinct steps involved in allocating the Board's administrative costs. The first step is the allocation of the total cost of the sales and use tax program to the State, Bradley-Burns, and STJs. The second step is the allocation of the total Bradley-Burns cost and the total STJ cost to each Bradley-Burns entity and each STJ.

<u>Allocating the sales tax program cost to the State, Bradley- Burns, and STJs:</u>

The Board's administration of the sales and use tax program encompasses four basic service elements: 1) registering taxpayers, 2) processing returns and payments, 3) auditing taxpayers' records, and 4) collecting delinquent taxes. The existing model begins with the cost of each of the four sales and use tax program elements (Registration, Returns, Audit, and Collection) as reflected in the approved Governor's Budget.

The existing model identifies direct costs associated with Bradley-Burns and STJ workloads. Direct costs are the marginal costs that the Board would not incur if it were not for the local administered taxes. The State and the Bradley Burns incurs few direct costs because it is difficult to identify activities from which only they derive benefits. The STJs incur the most direct costs. For STJs, the direct costs are determined using workload indicators such as audit hours, number of permits, and number of returns.

From the total sales tax program cost, the model subtracts the direct costs to compute shared costs. Shared costs are those costs that benefit the state, Bradley Burns, and STJs individually and jointly but cannot be separately identified and associated with each entity. An adjustment is then made for costs that are related to counties that do not have STJs from costs that are shared between the State, Bradley Burns, and STJs. To calculate the amount of shared costs allocated to STJs, the model uses workload factors. The remaining shared cost, including the cost of the counties that do not have STJs, is allocated to the State and Bradley Burns based on revenue.

Next, the model allocates central agency costs, which are those costs incurred by the State's central service departments for activities that benefit all state departments (e.g. the State Controller's Office, the State Treasurer, and the Department of Finance). Central agency costs vary from year to year and are about 4 percent of the total sales and use tax program costs and are prorated to the State, Bradley Burns, and STJs based on their total direct and shared cost.

The model also allocates the costs the Board is charged by the Department of Motor Vehicles and the Housing and Community Development Agency for the work they perform in collecting State and local sales and use tax revenues.

Allocating the Bradley Burns and STJ cost to each jurisdiction:

After the total costs have been calculated for the State, Bradley Burns, and the STJs, the Bradley Burns amount and the STJ amount must be allocated to each Bradley Burns entity and each STJ. For Bradley Burns, the total cost is allocated to each Bradley Burns entity based on revenue. For STJs, the allocation uses complex workload factors as recommended by the Auditor General reports. Also, for STJs, the Board is limited on the amount it may charge STJs. This amount is capped at a percentage of revenue depending on the STJ's tax rate.

STJ Cap

The model includes a cap on the amount that the Board can charge individual STJs. The cap was put into place by legislation beginning with the 1998-99 fiscal year. The following table illustrates the maximum allowable fees the Board can charge an individual STJ:

STJ Tax Rate	Allowable Fee
0.50% or greater	1.50% of revenue
0.25% up to but less than 0.50%	3.00% of revenue
Less than 0.25%	5.00% of revenue

Beginning with the 1998-99 fiscal year, and each fiscal year thereafter, for any existing STJ, their permanent cap is based on the lesser of the statutory cap (see table above) or their cost as a percentage of revenue in the 1998-99 fiscal year. For STJs that came into existence after 1998-99, their permanent cap is the lesser of the statutory cap or their cost as a percentage of revenue in their first full year of existence.

BACKGROUND

Legislative Analyst's Office - Supplemental Report of the 2004 Budget Act

- During the 2004-05 Budget enactment process, the LAO considered removing the cap on the amount the Board can charge individual STJs to administer their transactions and use tax ordinance. However, the 2004 Budget Act retained the cap, while the LAO recommended that the Board provide an analysis of methodological approaches for allocating administrative costs.
- In its "Supplemental Report of the 2004 Budget Act," the LAO requested that the Board provide to the Chair of the Joint Legislative Budget Committee (JLBC) and chairs of the fiscal committees of the Legislature by December 1, 2004, a report of an analysis of methodological approaches to allocating the administrative costs of collecting the state and local sales and use taxes among the state General Fund, special funds, Bradley Burns, and transactions and use taxes. The analysis and report was to be prepared in consultation with the LAO, the DOF, and appropriate local government representatives and would contain detailed information regarding cost allocation methodologies for various activities based on workload or other factors, including their fiscal implications.

Board of Equalization - Response to the Supplemental Report of the 2004 Budget Act

- In November 2004, the Board provided to the Chair of the JLBC and chairs of the fiscal committees a report entitled, Response to the Supplemental Report of the 2004 Budget Act Response to the Supplemental Report of the 2004 Budget Act.doc. The report included four alternative approaches to the Board's existing cost model, each of which provided a simpler approach to calculating and allocating the various costs. A simpler approach was taken because the complexity of the existing model has made it more cumbersome to administer and difficult to explain to local entities. Most of the existing model complexity results from using complex workload factors (such as number of seller's permits, number of returns, and audit hours) that are cumbersome to administer and yet do not necessarily produce greater accuracy than other, simpler methods.

Legislative Analyst's Office - 2006-07 Analysis of the Governor's Budget

- In its analysis of the 2006-07 Governor's Budget, the LAO recommended the enactment of legislation implementing a simplified methodology for allocating the Board's administrative costs. The LAO recommended the adoption of the "modified revenue" model (Alternative 4C and referred also as the "revenue approach") for allocating costs. The LAO commented that the Board's costing model, due to various statutory requirements, has become increasingly complex and expensive to administer. In addition, as new STJs have been established, adjusting the model has become an expensive and resource-intensive undertaking.
- In addition, according to the LAO, the "modified revenue" model (Alternative 4C) is a more reasonable method to allocate costs than the one currently used. In developing the various alternatives, the Board, in consultation with the LAO, DOF, and STJ representatives, attempted to address specific goals and features. Those goals and features are: 1) relatively straightforward to determine; 2) methodology can be easily explained; 3) reasonably related to each tax component's cost; and 4) can readily incorporate additional STJs. According to the LAO, Alternative 4C best achieves these goals while also removing the current somewhat arbitrary cap on administrative costs as a percentage of revenue. The LAO noted that the adoption of the "modified revenue" model (Alternative 4C) would result in a reduction in costs borne by the state General Fund and the STJs, with an increase in costs borne by Bradley Burns. This reduction in the costs borne by the General Fund would translate to a General Fund savings of approximately $6 million annually, with an increase in Bradley Burns reimbursements by an identical amount.

COMMENTS

1. Purpose. As part of the 2006-07 Governors' Budget, the LAO recommended the enactment of legislation implementing a new simplified methodology for allocating administrative costs associated with the sales and use tax on behalf of the state and various local entities. The adoption of a new costing methodology would result in an estimated $6 million to the state General Fund with a corresponding increase in the amount of reimbursements from the Bradley Burns entities.

2. **Technical amendments.** Section 7204.3 incorrectly uses the term "district," rather than "local entity." Section 7204.3 requires the Board to charge each city, city and county, county or redevelopment agency for the services it provides in administering the local entity's tax ordinance. This statute covers a local entity (i.e., city, city and county, county, or redevelopment agency) but does not cover a district. The term "district" refers to tax districts under the Transactions and Use Tax Law, not local entities under Bradley-Burns Uniform Local Sales and Use Tax Law. To correct this error, the following amendment is suggested:

    7204.3. (a)(2) The amount charged each ~~district~~local entity shall be adjusted to reflect the difference between the board's recovered costs and the actual costs incurred by the board during the fiscal year two years prior.

    With respect to Section 7273 of the Transactions and Use Tax Law, subdivision (a) (1) of Section 7273 was amended to add "each district" to this provision. For consistency, it is suggested that the phrase "each district" be added to subdivision (a) (2) of Section 7273:

    7273. (a)(2) The amount charged each district shall be adjusted to reflect the difference between the board's recovered costs and the actual costs incurred by the board during the fiscal year two years prior.

3. **Explanation of Alternatives 4A (shared approach), 4B (marginal approach), and 4C (revenue approach).** As previously stated, the Board, in consultation with the LAO, DOF, and local government representatives, developed four proposed alternatives for allocating administrative costs to the State, Bradley Burns, and the STJs. The fourth alternative includes three sub-options. Alternatives 4A, 4B, and 4C all allocate Registration costs based on revenue from returns, Audit costs based on revenue from audit and investigative liabilities (including both over and under reported amounts), and Collections cost based on revenue from delinquent taxes billed. In each sub-option, the Returns element cost is allocated differently. In 4A (shared approach), the generic lines are allocated equally (1/3 each) to the State, Bradley Burns, and STJs. In 4B (marginal approach), the generic lines are allocated entirely to the state. In 4C (revenue approach also referred to as "modified revenue") the generic lines are allocated to State, Bradley Burns, and STJs based on to total revenue.

Tax Expenditure Reports
Government Code Section 13305

LAW PRIOR TO AMENDMENT

Since 1971, pursuant to Section 13305 of the Government Code, the Department of Finance (DOF) has been required to provide a tax expenditure report to the Legislature. Chapter 1762, Statutes of 1971, required that the report be submitted to the Legislature once every two years. Chapter 268, Statutes of 1984, increased the reporting frequency to once a year. The required report includes each of the following:

- A comprehensive list of tax expenditures.
- Additional detail on individual categories of tax expenditures.
- Historical information on the enactment and repeal of tax expenditures.

AMENDMENT

This bill amends, repeals and adds Section 13305 of the Government Code to, beginning January 1, 2007, require the DOF to provide a report to the Legislature by September 15th of each year on each tax expenditure exceeding $5 million annually. The report shall include the following information for each tax expenditure:

- The statutory authority;
- A description of the legislative intent, where the act adding or amending the expenditure contains legislative findings and declarations of the intent, or such intent is otherwise expressed or specified by the act;
- The sunset date, if applicable;
- A brief description of the beneficiaries of the tax expenditure;
- An estimate or range of estimates for the state and local revenue loss for the current fiscal year and the two subsequent fiscal years. For sales and use tax expenditures, this would include partial year exemptions and all other tax expenditures when the Board has obtained such information;
- For sales and use tax and personal and corporation tax expenditures, the number of returns filed or taxpayers affected, as applicable, for the most recent tax year for which full year data is available; and
- A listing of any comparable federal tax benefit, if any, and;
- A description of any tax expenditure evaluation or compilation of information completed by any state agency since the last report made under this section.

This bill defines a “tax expenditure” as a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by state law.

The provisions became effective immediately upon enactment, but are operative on January 1, 2007.

BACKGROUND

There have been several bills introduced during the last few years related to tax expenditure reports. These include:

AB 168 (Ridley-Thomas, 2005) would have required: (1) the Board and the Franchise Tax Board (FTB) to each provide to the Legislature, the DOF and the Legislative Analyst Office (LAO), a report, based on a static revenue analysis, of the estimated revenue losses attributable to each tax expenditure, to the extent feasible, that produced a revenue loss in excess of $25 million in the prior fiscal year; (2) the DOF to provide, biennially, to the Legislature and the LAO, a report, based on a dynamic revenue analysis, of the estimated revenue losses attributable to tax expenditures that produced revenue losses in excess of $25 million, as specified; (3) the LAO to review the reports and make recommendations to the Legislature as to which tax expenditures should be modified or repealed.

AB 168 was vetoed by Governor Schwarzenegger and the veto message states:

> "The Department of Finance and the Legislative Analysts Office currently have broad authority to review and report tax expenditures to the Legislature. This bills restatement of the existing tax reporting requirements is redundant and unnecessary."

AB 735 (Arambula, 2005) would have: (1) required the LAO to establish a process to review all tax exceptions, and submit a report to the Legislature by December 31, 2006; (2) required the LAO to review and analyze any relevant reports prepared by the DOF, and request assistance from the Board and the FTB in order to make the report as comprehensive as possible; and (3) directed the Assembly and Senate Revenue and Taxation Committees to review the report submitted by the LAO and authorize them to select a group of tax exceptions for deletion or modification, reporting their recommendations to the fiscal committees for consideration during the budget process. This bill was never heard by a committee.

SB 577 (Figueroa, 2005) would have, among other things, required the DOF, in consultation with the Board and the FTB, to report to the Legislature by January 1, 2008, on the effectiveness of "tax expenditures," as defined. This provision was amended out of the bill.

AB 2106 (Ridley-Thomas, 2004) would have, among other things, required the DOF, in conjunction with the Governor's Budget, to submit to the Legislature a report of tax expenditures currently in effect. The bill would have specified that, among other things, based on information provided by the Board to the extent feasible, the report include the number of tax returns or taxpayers affected by any sales or use tax expenditure, the distribution of that expenditure, and the size and type of business or industry to which that expenditure is made available.

AB 2106 was vetoed by Governor Schwarzenegger and the veto message states:

> "Under existing law, the Department of Finance already is required to provide an annual tax expenditure report to the Legislature containing specific information. This bill changes the type of information that is

provided in the annual report. However, some of the information that Department of Finance would be required to report is not available. For example, the original intent of a given tax expenditure is often not clearly defined in the enabling statute. In addition, the number and income distribution of taxpayers benefiting from sales tax exemptions would not be known because this information is not required to be reported by retailers when filing their tax returns. Furthermore, some of the information might not be available for reporting to the Legislature because of existing confidentiality requirements."

COMMENTS

1. **Purpose.** This budget trailer bill, among other things, revises and enhances the existing DOF statutory requirement to report on tax expenditures as specified in Government Code Section 13305. At the May 11, 2006 Senate Budget and Fiscal Review – Subcommittee No. 4 hearing, tax expenditures were discussed and committee staff recommended that the Legislature consider devoting greater attention to tax expenditures using the three following objectives: 1) understanding their intentions and implications, 2) gaining better access to information, and 3) revising and enhancing reporting. Objective 3 would be achieved by revising and enhancing the existing statutory reporting requirements related to the DOF's annual tax expenditure report.

2. **Should the term "partial year exemptions" be changed to "partial exemptions?"** This bill provides that the annual tax expenditure report include an estimate or range of estimates for the state and local revenue loss for the current fiscal year and the two subsequent fiscal years. This bill specifies that, for sales and use tax expenditures, the information would include *partial year exemptions* and all other tax expenditures when the Board has obtained such information.

   Would the term *partial year exemption* mean an exemption that has been operative for a partial fiscal year, or did the Legislature mean to include those partial exemptions for which the sale or purchase is exempt from a portion of the sales and use tax? The Board administers full exemptions and partial exemptions. There are currently five partial exemptions in effect (see Comment 3). These partial exemptions apply to the 5 percent state General Fund portion of the tax, but do not apply to the two 0.5 percent statewide taxes (i.e., Local Revenue Fund and Local Public Safety Fund), or the taxes imposed under the Bradley-Burns Uniform Local Sales and Use Tax Law and the Transactions and Use Tax Law.

   It appears that the intent of the bill is to state that the tax expenditure report would include information on *partial exemptions*, rather than an exemption that is operative for a *partial fiscal year*.

3. **The Board does not have specific data on tax expenditures.** This bill requires that the annual tax expenditure report include an estimate of the state and local revenue loss for a three-year period. This bill specifies that, with respect to sales and use tax expenditures, the information include partial year

exemptions and all other tax expenditures when the Board has obtained such information. An explanation regarding the information obtained on the sales and use tax returns, including the differences between tax return data captured for state income tax purposes versus tax return data captured for sales and use tax purposes, is provided below:

- Sales and Use Tax Expenditure Reporting

  In general, revenue estimates and expenditure data for the Personal Income Tax and Corporation Tax Laws are easier to quantify than for the Sales and Use Tax Law. Personal income and corporation tax returns contain significant detail information regarding different sources of income and types of exemptions, exclusions, deductions, and credits claimed. Thus, tax return data are often available when estimating the fiscal impact of various income and corporate tax expenditure programs. In contrast, returns filed by taxpayers under the Sales and Use Tax Law www.boe.ca.gov/pdf/boe401a2.pdf contain little information regarding tax expenditures.

  As shown on the attached sales and use tax return, some of the more common tax expenditures allowed under the Sales and Use Tax Law are separately identified on the return itself for purposes of allowing taxpayers to claim the deduction. These include deductions for, but not limited to, sales of food products, sales to the U.S. Government, sales in interstate or foreign commerce, and nontaxable labor (note, the law contains numerous other tax exemptions and exclusions not separately identified on the return).

  However, instead of actually itemizing these deductions, many taxpayers simply report their taxable sales, netting out any exempt sales. Any attempt to capture the amount of exempt transactions would require a much more extensive tax return and would require a very large effort from taxpayers to detail these transactions.

  Consequently, return information does not capture specific data on the myriad of tax exemptions and exclusions provided under the law, and is not a reliable source to use in making estimates of revenue losses attributable to those exemptions and exclusions. As such, the Board generally relies on independent data sources when estimating the revenue impacts of various sales tax expenditure programs.

- Partial Sales and Use Tax Expenditure Reporting

  The exception to this is for partial exemptions. The Board currently requires the taxpayer to specify the amount of those exemptions that apply to only a portion of the combined state and local sales and use tax. There are currently five such exemptions in effect:

  - Teleproduction Equipment
  - Farm Equipment
  - Diesel Fuel Used in Farming and Food Processing
  - Timber Harvesting Equipment and Machinery

- Racehorse Breeding Stock

Sales of these items are exempt from a portion of the state sales and use tax. Local and special district sales and use taxes continue to apply. In order for a taxpayer to claim these partial exemptions, they must report the amount of the transactions that are subject to the partial exemption. For these partial exemptions, the Board knows how much is being claimed as well as how many retailers are claiming the partial exemption.

4. **The Board's Publication 61, *Sales and Use Taxes: Exemptions and Exclusions*, provides a detailed listing of various exemptions and exclusions from the sales and use tax.** The publication has two listings: one by category and another by alphabetical reference. The listings provide a brief general description of the exemption or exclusion, including the statutory authority. The listing by category also provides an estimate of the revenue loss of the exemption or exclusion, if available. As previously stated in Comment 3, a revenue loss of a particular tax expenditure is not always possible to quantify.

5. **Related legislation.** AB 1933 (Coto) would have required the DOF to review, over a 10-year period, all tax expenditures in excess of $1 million that are in existence since January 1, 2007, and would have required any legislative measure creating a new tax expenditure, or extending the operation of an existing tax expenditure, to meet certain requirements, as specified. This bill failed passage in Senate Revenue and Taxation Committee on June 28, 2006.

Assembly Bill 2239 (Emmerson, et al.) Chapter 352

Vehicles Brought Into California for Repairs

Tax levy; effective September 20, 2006. Amends Section 6248 of the Revenue and Taxation Code.

BILL SUMMARY

This bill provides that, for purposes of the rebuttable presumption applicable to vehicles, vessels and aircraft purchased outside this state and brought into California within 12 months from the date of purchase, the presumption may be controverted by documentary evidence that the vehicle was brought into this state for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less, as specified.

Sponsor: California Recreational Vehicle Association

LAW PRIOR TO AMENDMENT

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 undocumented vessel, to the Department of Motor Vehicles (DMV).

Under the law, 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 in another state or in a foreign country using the retailer's own delivery vehicle or another means of transport that the retailer owns; or
- Ships the product to another state or to a foreign country by delivering it to a common carrier, contract carrier, customs broker, export packer, or forwarding agent.

Section 6248 of the Sales and Use Tax Law, as amended by SB 1100 (Stats. 2004, Ch. 226), and extended by AB 1809 (Stats. 2006, Ch. 49), provides that, for the period October 2, 2004, through and including June 30, 2007, 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.

This section 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. Such evidence includes, but is not limited to, proof of registration of that vehicle, vessel, or aircraft with the proper authority outside of this state. In addition, the law specifies that these 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, Section 6248 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. This section has no similar exception for repairs, retrofitting, or modifications of a vehicle.

AMENDMENT

This bill amends Section 6248 of the Sales and Use Tax Law to specify that, for purposes of the rebuttable presumption applicable to vehicles, vessels and aircraft purchased outside this state and brought into California within 12 months from the date of purchase, the presumption may be controverted by documentary evidence that the vehicle was brought into this state for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less.

The bill specifies that the 30-day period begins when the vehicle enters this state, including any time of travel to and from the warranty or repair facility, and ending when the vehicle is returned to a point outside the state.

The bill further provides that the documentary evidence shall include a work order stating the dates that the vehicle is in the possession of the warranty or repair facility and a statement by the owner of the vehicle specifying dates of travel to and from the warranty or repair facility.

As a tax levy, the bill became effective immediately upon enactment.

BACKGROUND

Section 6248 was added to the Sales and Use Tax Law in 1963 and provided a rebuttable presumption that a vehicle bought outside this state that is brought into California within 90 days from the purchase date was purchased for use in this state, and therefore, subject to California's use tax. The amendments to Section 6248 that occurred by Stats. 2004, Ch. 226 (SB 1100), were part of the tax-related provisions of the 2004-05 budget package. These provisions were extended by an additional year as part of the tax-related provisions of the 2006-07 budget package. These amendments to Section 6248 were prompted by a perceived tax loophole with respect to the "90-day" law.

Under the "90-day" law, there were instances in which, for example, 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.

The 12-month provisions incorporated into Section 6248 were intended to reduce the frequency of these sorts of arrangements.

COMMENTS

1. **Purpose.** The purpose of this bill is to provide a reasonable exception to the strict 12-month rule for vehicles, in a manner similar to the exception provided to vessels and aircraft, by allowing purchasers of automobiles, RVs and other vehicles to bring the vehicle into California within 12 months of the date of purchase for no more than 30 days in order to service their vehicles without incurring a use tax liability.

2. **Key amendments.** The **August 16, 2006 amendments** provided that the rebuttable presumption contained in Section 6248 may be controverted by documentary evidence, as specified, that the vehicle was brought into this state for the exclusive purpose of warranty or repair service, and was used or stored in this state for that purpose for 30 days or less, as specified. The **August 7 amendments** deleted the former provisions that would have required the DMV to provide information to a person applying for registration of a vehicle purchased outside the state and brought into the state within the first 12 months of the purchase date, that the applicant may not be liable for the tax on the purchase and use of a vehicle pursuant to the Revenue and Taxation Code. Instead, the amendments provided that, for purposes of the rebuttable presumption, a vehicle brought into this state within 12 months of the date of purchase for the exclusive purpose of warranty or repair service shall not be deemed to be acquired for storage, use, or other consumption in this state. The **April 4, 2006 amendments** incorporated the provisions requiring DMV to provide the information to vehicle registration applicants. The introduced version of this measure was a spot bill, making a nonsubstantive change to Section 6248.

3. **Provisions do not appear to significantly impact administration of Section 6248.** Since October 2, 2004, the Board has been administering the exception provided in Section 6248 for the repair, retrofit and modification to vessels and aircraft brought into this state within the first 12 months of purchase. Thus far, staff has not observed instances in which purchasers are attempting to use this exception as a way to bring their vessel or aircraft into California under a repair "sham" just to maintain the exemption. Therefore, staff doesn't anticipate any significant administrative problems with the provisions of this measure.

Assembly Bill 2303 (Committee on Judiciary) Chapter 567

Car Buyer's Bill of Rights – Technical Cleanup

Effective January 1, 2007. Among its provisions, amends Section 11713.21 of the Vehicle Code.

BILL SUMMARY

Among other things, this bill makes several technical amendments to the Car Buyer's Bill of Rights, one of which clarifies that the two-day contract cancellation option applies to sales of used vehicles with a purchase price of *under* $40,000. The remainder of this bill makes numerous, non-controversial changes to the California Codes.

Sponsor: Committee on Judiciary

LAW PRIOR TO AMENDMENT

Under current law, beginning July 1, 2006, Assembly Bill 68 (Ch. 128, Stats. 2005, Montanez) enacted the Car Buyer's Bill of Rights, which, among other things, added Section 11713.21 to the Vehicle Code to require a car dealer to offer a two-day contract cancellation option agreement on used vehicles with a purchase price of less than $40,000, and allows the purchaser to return the used vehicle without cause, provided that specified conditions are met. The contract cancellation option applies only to used vehicles sold for personal, family, or household use. The option does not apply to the sale of motorcycles, off-highway vehicles, or recreational vehicles.

The maximum price a car dealer may charge for the contract cancellation option agreement is based on the cash price of the vehicle:

Cash price of vehicle[1]	**Maximum amount charged for contract cancellation option agreement**
Up to and including $5,000	$75
$5,000.01, up to and including $10,000	$150
$10,000.01, up to and including $30,000	$250
$30,000.01, but less than $40,000	1% of the purchase price

[1] The cash price of a vehicle, as defined by Civil Code Section 2982(a)(1)(A), excludes document preparation fees, tax imposed on the sale, pollution control certification fees, prior credit or lease balance on property being traded in, and the amount charged for a service contract. Vehicle Code Section 11713.21 (a)(2)(D) adds that the cash price also excludes registration, transfer, titling, license, and California tire and option business partnership automation fees.

Subdivision (a)(2)(D) of Section 11713.21 provides that for a vehicle with a cash price of more than $30,000, but not more than $40,000, the maximum amount that a dealer can charge for the option is one percent of the purchase price of the vehicle. However, under subdivision (a)(1), the two-day contract cancellation option applies only to used vehicles with a purchase price of less than $40,000. In order for subdivision (a)(2)(D) to be consistent with subdivision (a)(1), as well as other sections of the Car Buyer's Bill of Rights, Board staff requested a technical amendment to correct this inconsistency. The amendment to this bill would simply clarify that the charge of one percent of the purchase price for a contract cancellation option applies to a used vehicle sold for more than $30,000, but less than $40,000 (and not *exactly* $40,000), which is consistent with the intent of the original bill.

AMENDMENT

This bill amends Section 11713.21 of the Vehicle Code to clarify that the maximum amount of one percent of the purchase price applies to a vehicle with a cash price of more than $30,000, but less than $40,000 (and not *exactly* $40,000).

COMMENTS

1. **Purpose.** The purpose of this bill is to implement non-controversial technical corrections to the law.
2. **The August 7, 14, 23, and 28, 2006 amendments** were technical cleanup amendments that did not impact the Board. The **June 22, 2006 amendments** were technical cleanup amendments to the Car Buyer's Bill of Rights, which were suggested by the Board staff. The amendments clarify that the contract cancellation option applies to a vehicle sold for less than $40,000, which are consistent with the intent of the original bill (AB 68), as confirmed by the author, Assembly Member Montanez's, office.

Assembly Bill 2533 (Leno) Chapter 281

Leases of Art Work

Tax levy; effective September 14, 2006, but operative January 1, 2007. Amends Section 6365 of the Revenue and Taxation Code.

BILL SUMMARY

This bill provides an exemption from the sales and use tax on the lease of original works of public art if both the lessor and lessee are nonprofit organizations or government entities. This bill also clarifies that a work of art may include clothing, costumes, dresses, and personal adornment.

Sponsor: California Historical Society

LAW PRIOR TO AMENDMENT

Existing law, Revenue and Taxation Code Section 6365, provides an exemption for sales of original works of art which are purchased by:

- A governmental entity or any nonprofit organization operating a museum under contract for a governmental entity.
- A nonprofit organization, qualified for exemption from state income tax under Section 23701d, that purchased the work of art for display in a museum open to the public, as specified, either operated by the purchaser or another nonprofit organization qualified for exemption pursuant to Section 23701d.
- Any person donating to the above governmental entity or nonprofit organizations. The transfer must occur and be documented as specified.

In general, the exemption provided to the above described governmental entity or nonprofit organizations, applies only to original works of art which are purchased to become part of the permanent collection of either a museum, a qualified nonprofit organization that is required to loan out its art for display to museums, or a governmental entity which purchases or commissions art for display in public places.

Section 6366.4 exempts purchases of museum pieces only for the San Diego Aero-Space Museum and the California Science Center, and Section 6366.3 exempts purchases of display pieces replaced due to destruction by calamity.

Original works of art are further defined by Board Regulation 1586 as, "tangible personal property which has been created as a unique object intended to provide aesthetic pleasure to the beholder and/or to express the emotions of the artist." The form of this art includes but is not limited to: visual art, a work of calligraphy, a work of graphic art, crafts, or mixed media.

Under current law, purchases of art, not meeting the criteria of Section 6365, and clothing such as dresses, costumes, and personal adornment (e.g. crown, cane, belt, shoes, hat, wig, etc.), are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute.

AMENDMENT

This bill amends Section 6365 to exempt from the sales and use tax the lease of original works of art, as specified, if both the lessor and lessee are nonprofit organizations qualified for exemption from state income tax under Section 23701d. The bill provides that in order for the art collection to be considered part of the permanent collection of the lessee the lease term must be at least 35 years.

This bill also provides that the exemption would apply to works of art that are purchased and become part of the permanent collection of a governmental entity that leases from another governmental entity art for public display.

Additionally, the bill clarifies the law to specify that purchases of clothing, costumes, dresses, and personal adornment that are works of art as further defined in Regulation 1586(b)(1) are exempt from tax.

The provisions of this bill became effective immediately, but operative on January 1, 2007.

COMMENTS

1. **Purpose.** The purpose of this measure is to allow leases of works of art, including dresses and costumes, between certain nonprofit organizations to be exempt from tax. The leases will be based on a collection sharing agreement, of not less than 35 years, that allows museums to share parts of their art collections that may not be on display, due to the size of the museum, type of collection, or for other reasons, and share them with museums with larger space or similar collections. Structured as a lease, these sharing agreements allow the nonprofit organizations to retain title to their pieces while generating funds to support other exhibits and programs, provide continuing educational material, and enhance the overall enjoyment and appreciation of art.

2. **Key amendments.** The **April 17, 2006, amendments** clarified that only those nonprofit organizations defined in the current statute would be eligible for exemption of leases of original works of art. Additionally, the amendments defined “permanent collection,” as it applies to leases of original works of art, as a collection with a lease term of 35 years or more. Finally, the amendments clarified that governmental entities may lease works of art for public display from each other.

3. **What transactions are currently exempt?** The Board has made previous determinations regarding what constitutes a work of art. For example, Sales and Use Tax Annotation 610.0500 suggests that a utilitarian object, such as a dress, could be considered to be a work of art if it is an original work designed to have significant artistic value. It must be hand-crafted by, or under the direction of, an artist or master craftsman, rather than mass produced. If the aesthetic value of the dress is greater than the practical value, then it may be considered a work of art due to its uniqueness and extra effort to “provide aesthetic pleasure to the beholder and/or to express the emotions of the artist.” Additionally, the Board

has decided that tangible personal property used by an artist in an “assemblage” was considered to be “mixed media,” and exempt as an original work of art. Depending on the exhibit, it is possible for a dress to be exempt if part of an assemblage. According to the sponsor of this bill, most of the pieces involved in the collection sharing agreement are from the 19th and early 20th century.

4. **Clothing that has historical value.** A lease or purchase of historical clothing that has historical value may still not be exempt from the Sales and Use Tax Law. The exemption provided by Section 6365 is intended to cover a work of art and is not a blanket coverage of all items purchased or leased by a museum. In other words, any dress, costume, or clothing must first meet the definition of an original work of art.

Assembly Bill 2591 (Keene) Chapter 506

State Agencies - Accounts Receivable

Effective January 1, 2007. Adds and repeals Section 13292.5 to the Government Code.

BILL SUMMARY

This bill requires certain state agencies, including the Board, to prepare annual reports identifying accounts receivables that are valid and collectible, as defined, for 180 or more days and efforts to collect these accounts. This analysis is limited to the effect on the Board's reporting requirements.

Sponsor: California Association of Collectors

LAW PRIOR TO AMENDMENT

Currently, the Board is authorized to use various collection actions to effect the collection of delinquent taxes, including but not limited to: bank levies, wage garnishments, tax liens, seizure of assets, offsets, and court actions. The Board uses these tools consistent with its established policies and procedures.

Existing law, Chapter 4.3 (commencing with Section 16580) of Part 2 of Division 4 of Title 2 of the Government Code, known as the Accounts Receivable Management Act, authorizes each state agency to sell part or all of its accounts receivables to private debt collectors under specified conditions. One of those conditions is that a debt that has been contested can not be assigned or sold. Each state agency is also required to consult with the Franchise Tax Board or other state agencies which have established an effective accounts receivable collection system.

Additionally, Chapter 3 (commencing with Section 13940) of Part 4 of Division 3 of Title 2 of the Government Code allows the Board to make an application for discharge from accountability (discharge) to relieve the agency of the responsibility for collection, thereby removing the item from the accounts receivable base.

AMENDMENT

This bill adds Section 13292.5 to the Government Code to require the Board, Franchise Tax Board, State Lands Commission, Department of General Services, Department of Motor Vehicles, Department of Real Estate, and the Department of Corporations to submit an annual report to the Department of Finance (DOF) detailing the status of the agency's liquidated and delinquent accounts, as defined, and efforts to collect these accounts during the previous fiscal year. The reports will identify those receivables that are valid and collectible and will only be prepared if sufficient existing resources are available. For the purposes of this bill, "valid" is defined as a receivable that is due and payable and for which there is no known disagreement about the amount of the claim at the time it was established. "Collectible" means a receivable that is due and payable and for which collection has not been deferred by any other provision of law.

The report will include a summary of the total of all of the following:

- Total number and aggregate dollar amount of liquidated and delinquent accounts.
- Liquidated and delinquent accounts, by total number and aggregate dollar amount, that were not included in the annual report for the immediately preceding fiscal year.
- Aggregate beginning balance and aggregate ending balance of each liquidated and delinquent account.
- Aggregate dollar amount of moneys paid on liquidated and delinquent accounts.
- Total amount and total number of liquidated and delinquent accounts that have been discharged from accountability.
- Total dollar amount of liquidated and delinquent accounts turned over to private collection agencies and total amount collected by those agencies for the fiscal year that is the subject of the report.
- A listing of the liquidated and delinquent accounts by specified time periods, which, at a minimum, shall identify the total number and aggregate dollar amount of liquidated and delinquent accounts that are unpaid for 180 or more days after the obligation was first due.

The state agencies are required to submit the accounts receivable report to the DOF by October 31 of each year. The DOF will then submit their report to the Legislature no later than February 28 of each fiscal year.

This bill is effective January 1, 2007 and will be inoperative July 1, 2010, with a repealed date of January 1, 2011.

BACKGROUND

Due to its effective tax administration, the Legislature and other state agencies who have contracted with the Board have given the Board the responsibility for administering various taxes and fees. Currently, the Board administers over 20 different tax and fee (tax) programs. As indicated in the Board's 2004-05 Annual Report, those programs generated $49.95 billion in revenue at a cost of $209.04 million – only 68 cents for every $100 of revenue collected.

Despite the best of efforts, certain tax debts are not readily collectable. After a liability has become due and payable, a taxpayer may avail themselves of several alternatives that could result in the aging of the receivable. For example, taxpayers may enter into installment payment agreements with the Board. Some of these payment plans are short-term (under twelve months), others are long-term, and the result is a cooperative resolution of the receivable. Other taxpayers may file a bankruptcy petition which imposes an automatic stay of collection actions. Still others file a "late protest," which is an administrative process that allows a taxpayer to file a late appeal which may result in the deferral of collection actions.

In general, collection of an accounts receivable progresses through various automated and manual collection processes. After collection efforts have been exhausted and it is determined that it is no longer cost effective to pursue collection of an outstanding liability, a discharge recommendation is initiated as provided in the Government Code and further specified in the State Administrative Manual (SAM) section 8776.6. Requests for discharge from accountability are submitted to the State Controller's Office for review, and those accounts with balances over $5,000 may be reviewed by the Attorney General's office.

The SAM is a resource available to state agencies that covers statewide policies, procedures and information. Section 8776.2 of the SAM provides a definition of a valid account receivable that is similar to the definition used in this bill. Additionally, the SAM explains that valid accounts receivables are divided into "current" and "deferred." In short, a current receivable is expected to be collected within a year, while a deferred receivable is expected to be outstanding for over a year.

COMMENTS

1. **Purpose.** The purpose of the bill is to provide the Legislature with information on the total amount of money owed to the State that has not been collected in the previous fiscal year. According to the author's office, the information in the report would allow the Legislature to consider how to better manage and collect the debt.

2. **Key amendments.** The **August 29, 2006 amendments** added an additional state agency that needs to prepare a report. The **August 28, 2006 amendments** specified six state agencies that need to produce the required report. In addition, the accounts receivable report is to identify valid and collectible accounts, and the agencies shall only provide the report if they have sufficient existing resources. The **August 7, 2006 amendments** prohibited a state agency from contracting with a private collection agency to prepare the report. The **June 20, 2006** amendment was a technical non-substantive amendment. The **May 26, 2006 amendments** specified that each state agency is to submit a report to the DOF no later than October 31 of each year, until July 1, 2010. The DOF would then be required to submit a report to the Legislature by February 28 of each year, until July 1, 2010, based on the state agency reports. The statute is inoperative as of July 1, 2010, and is repealed as of January 1, 2011. **The April 26, 2006** amendments added a coauthor.

3. **What accounts receivables would the Board include in the report?** As stated previously, the Board collects various taxes and fees, so all of these may be subject to the reporting requirements. Those tax and fee accounts that are liquidated and delinquent, meaning they are owed but unpaid for 180 or more days, would be reported. Of those accounts reported, the Board must identify which ones are valid and collectible. A valid account will be those accounts that are due and payable and have no known disagreement about the amount owed. The Board will <u>not</u> consider a valid account to include, but not be limited to, those accounts accepted as a "late protest," an innocent spouse request, or a non-partner claim. The language is broad enough that it may exclude tax protestors from being considered a valid account. A collectible account will be those accounts that are due and payable and have not been deferred by any other

provision of law. The Board will <u>not</u> consider an account in bankruptcy status as a collectible account. Since "deferred" is not defined in this bill, it is unclear if the author intended SAM section 8776.2 to provide guidance, or only deferrals provided in state or federal statute.

4. **Efforts made by the agency to collect these accounts.** The bill requires the agencies to report the efforts made to collect the delinquent accounts but does not specify the detail needed to comply with this requirement. If the description of efforts to collect is general in nature then there would be absorbable costs to prepare an annual report. However, if the description must be detailed – an account by account listing of collection efforts – then implementation costs could be substantial.

5. **What fiscal years are to be included in the Board's report?** The first fiscal year included in the report will be the 2006-07 and will be due to the DOF no later than October 31, 2007. As for the final report, it is unclear whether the fiscal year 2009-10 is intended to be the final fiscal year of the report, since the bill becomes inoperative on July 1, 2010, a day after the end of that fiscal year. It would appear that the Board would not be required to submit a report to the DOF by October 31, 2010, since the statute would be inoperative. The author did not clarify which fiscal year will be in the final report.

Assembly Bill 3076 (Committee on Revenue and Taxation) Chapter 364

Technical Correction – Military Lapel Pin Exemption

Effective January 1, 2007. Among its provisions, amends Section 6360.1 of the Revenue and Taxation Code.

BILL SUMMARY

Among other things, this bill contains a Board-sponsored provision to amend Section 6360.1, relative to the military lapel pin exemption, to incorporate the correct reference to the United States Code.

Sponsor: Board of Equalization

LAW PRIOR TO AMENDMENT

Under existing law, Revenue and Taxation Code Section 6360.1 provides an exemption from the sales and use tax for the gross receipts from the sale in this state, or the storage, use or other consumption in this state, of a "Buddy Poppy" or any other symbolic, impermanent lapel pin that memorializes United States military veterans killed in foreign wars of the United States. Under existing law, the exemption applies to sales made by, or the storage, use or other consumption by, "any corporation established by the Congress of the United States pursuant to Chapter 7A (commencing with Section 111) of Title 36 of the United States Code, or any of that corporation's subordinate state or territorial subdivisions, local chapters, or auxiliaries."

Section 2 of the bill that added Section 6360.1, Senate Bill 3 (Ch. 316, Stats. 1995), indicates that the Legislature intended for the cross-reference to Chapter 7A of Title 36 of the United States Code to refer to Veterans of Foreign Wars (VFW) of the United States.

AMENDMENT

This bill amends Section 6360.1 to incorporate the correct reference in the United States Code that provides for the establishment of the VFW.

COMMENT

Purpose. Under legislation adopted in 1998, the provisions authorizing for the establishment of the VFW were moved from Chapter 7A of Title 36 of the United States Code (commencing with Section 111) to Chapter 2301 of Title 35 of the United States Code (commencing with Section 230101). This bill substitutes the correct reference to the United States Code in Section 6360.1.

Senate Bill 1341 (Cedillo) Chapter 373

AIDS/HIV Thrift Store Exemption

Tax levy; effective September 20, 2006. Amends Section 6363.3 of the Revenue and Taxation Code.

BILL SUMMARY

This Board co-sponsored bill extends until January 1, 2012, the sales and use tax exemption for sales of used clothing, household items, or other retail items by thrift stores operated for purposes of raising funds to provide medical, hospice, or social services for individuals with HIV or AIDS, which is due to sunset on January 1, 2007.

Sponsor: California Hospice and Palliative Care Association and Board of Equalization

LAW PRIOR TO AMENDMENT

Under current law, the sales tax or the use tax applies to the sale or use of tangible personal property (including second hand property) in this state, unless specifically exempted or excluded from the tax. Under current law Section 6363.3 of the Revenue and Taxation Code, as added by AB 3187 (Ch. 781, Stats. 1996, Martinez) provides a sales and use tax exemption for sales of used clothing, household items, and other retail items sold by thrift stores operated by a nonprofit organization. To qualify, the purpose of the thrift store must be to obtain revenue for the funding of medical, hospice, or social services to individuals with HIV disease or AIDS, and at least 75 percent of those net revenues must actually be expended for that purpose. AB 180 (Ch. 383, Stats. 2001, Cedillo) amended Section 6363.3 to extend the January 1, 2002 sunset date to January 1, 2007.

Current law also provides an exemption for sales by other charitable organizations. Under Section 6375 of the Revenue and Taxation Code, sales (including thrift store sales) by charitable organizations are exempt from sales and use tax under the following conditions:

1. The organization must be formed and operated for charitable purposes and must qualify for the “welfare exemption” from property taxation provided by Section 214 of the Revenue and Taxation Code.
2. The organization must be engaged in the relief of poverty and distress.
3. The organization’s sales or donations must be made principally as a matter of assistance to purchasers or donees in distressed financial condition.
4. The property sold must have been made, prepared, and assembled or manufactured by the organization.

Merchandise sold through thrift stores operated by Goodwill Industries, the Salvation Army, and St. Vincent de Paul, for example, qualify for the exemption under Section 6375.

AMENDMENT

This bill amends Section 6363.3 of the Revenue and Taxation Code to extend from January 1, 2007 to January 1, 2012, the sunset date on the exemption for sales of used clothing, household items, or other retail items by thrift stores operated by a nonprofit organization, if the purpose of the thrift store is to obtain revenue for the funding of medical, hospice, or social services to individuals with HIV or AIDS and at least 75 percent of the net income derived from the operations of the thrift store is expended for that purpose.

As a tax levy, this bill took effect on September 20, 2006.

BACKGROUND

AB 1667 (Knox, 2000) would have eliminated the sunset date for this same exemption. The bill failed passage in the Senate Revenue and Taxation Committee.

COMMENTS

1. **Purpose.** The purpose of this bill is to extend the sunset date on the existing exemption for sales by thrift stores operated for purposes of funding services to individuals with HIV or AIDS.

2. **Key Amendments.** The **June 21, 2006 amendments** clarified that at least 75 percent of the net income, rather than net revenues, must be spent on providing medical, hospice, or social services to benefit individuals with HIV or AIDS. The **March 23, 2006 amendments** provided a five-year sunset date of January 1, 2012, for the sales and use tax exemption for sales by thrift stores operated by a nonprofit organization that benefit individuals with HIV or AIDS, which is due to sunset on January 1, 2007. The introduced version of the bill would have made this exemption permanent.

3. **Provisions would not be problematic to administer.** Since the Board is already administering the sales and use tax exemption for thrift stores that benefit individuals with HIV or AIDS, extending the sunset date will not pose a problem for the Board.

4. **Board Action.** The Board, at the January 31, 2006 Board Meeting, voted to sponsor legislation that is identical to this bill.

Senate Bill 1449 (Migden) Chapter 252

Penalty for Tax Collected and Not Remitted

Effective January 1, 2007. Adds Section 6597 to the Revenue and Taxation Code.

BILL SUMMARY

This bill imposes a 40 percent penalty upon a person who knowingly collected sales tax reimbursement, as defined, or use tax and failed to timely remit that tax to the Board, except as specified.

Sponsor: Senator Carole Migden

LAW PRIOR TO AMENDMENT

Under California's Sales and Use Tax Law, sales tax is imposed on all retailers for the privilege of selling tangible personal property in this state, unless otherwise exempt. Under Section 1656.1 of the Civil Code, whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. The law presumes that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail if:

1) The agreement of sale expressly provides for such addition of sales tax reimbursement;
2) Sales tax reimbursement is shown on the sales check or other proof of sale; or
3) The retailer posts at his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

Civil Code Section 1656.1 also presumes that the gross receipts from the retail sale of tangible personal property includes sales tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) a notice stating that the price of the item or price of taxable items includes sales tax reimbursement.

Under Section 6203 of the Sales and Use Tax Law, an out-of-state retailer that is engaged in business in California is required to collect use tax on sales made to California consumers and remit that tax to the Board. Under the law, Section 6204 of the Sales and Use Tax Law specifies that the tax collected by the retailer constitutes a debt owed by the retailer to the State.

The Sales and Use Tax Law provides for a variety of penalties for a person's failure to comply with the law. However, the law does not provide for a specific penalty attributable to situations in which a taxpayer knowingly collects sales tax reimbursement or use tax and fails to timely remit the tax.

Under the law, there are penalties that are mandatory and imposed automatically, such as those imposed because payments are made late or returns are filed after the due date, and there are others that are discretionary and that may be assessed as a result of an audit. The main penalties that are imposed are summarized as follows:

Nature of Penalty	Rate	Section
Failure to file a return	10%	6511
Failure to timely remit the tax when due	10%	6591
Negligence or intentional disregard of the laws or regulations	10%	6484
Fraud or intent to evade the law or regulations	25%	6485
Knowingly not obtaining a valid permit in order to avoid the tax	50%	7155
Improper use of a resale certificate for personal gain or to evade the tax	*	6072; 6094.5
Registration of vehicle, vessel, or aircraft out-of-state to evade the tax	50%	6485.1; 6514.1
Failure to obtain evidence that operator of catering truck holds valid seller's permit	$500	6074
Failure of retail florist to obtain permit	$500 **	6077

* 10% of the tax due or $500 whichever is greater
**Plus any other applicable penalty

AMENDMENT

This bill adds Section 6597 to the Sales and Use Tax Law to provide that any person who knowingly collects sales tax reimbursement, as defined, or use tax, and who fails to timely remit that sales tax reimbursement or use tax collected to the Board, shall be liable for a penalty of 40 percent of the amount not timely remitted.

The bill references Section 1656.1 of the Civil Code for purposes of defining sales tax reimbursement, and further specifies that sales tax reimbursement shall also include any sales tax that is advertised, held out, or stated to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer.

The bill excludes from the proposed penalty any person whose liability for the unremitted tax averages $1,000 or less per month, or does not exceed 5 percent of the total amount of tax liability for which the tax was collected for the period in which the tax was due, whichever is greater.

The bill further provides relief from the proposed penalty if the Board finds that the person's failure to timely remit the tax was due to reasonable cause or circumstances beyond the person's control. The bill provides that "reasonable cause or circumstances beyond a person's control" includes, but is not limited to, any of the following that caused the person's failure to make a timely remittance:

- The occurrence of a death or serious illness of the person or the person's next of kin.
- The occurrence of an emergency, as defined

- A natural disaster or other catastrophe directly affecting the person's business operations.
- The Board failed to send returns or other information to the correct address of record.
- The person's failure to timely remit the tax occurred only once over a 3-year period, or once during the period in which the person was engaged in business, whichever period is shorter.
- The person voluntarily corrected errors in remitting the tax in prior periods and remitted payment of the liability prior to being contacted by the Board.

In addition, the bill specifies that the provisions shall apply to any determination made by the Board pursuant to Article 2 (commencing with Section 6481), Article 3 (commencing with Section 6511) and Article 4 (commencing with Section 6536) of Chapter 5, of the Sales and Use Tax Law.

The bill becomes operative January 1, 2007.

BACKGROUND

During the 2005 Legislative Session, a similar measure, SB 323 (Migden), was vetoed by the Governor. That measure would have imposed a 50 percent penalty for a person's failure to timely remit sales tax reimbursement. In his veto message, the Governor stated the following:

> "This bill creates a rigid and overly severe punishment for the failure to remit sales taxes which have been collected. I strongly support tough laws to punish and discourage scofflaws who knowingly evade taxes. However, this measure provides no flexibility for errors made by individuals with no intent to evade taxes or defraud the state. Moreover, the Board of Equalization does not contend that this bill would result in a specific level of increased compliance. For these reasons, I cannot support this bill."

COMMENTS

1. **Purpose.** The purpose of this bill is to enhance the penalty in cases where a retailer knowingly collects sales tax reimbursement or use tax from customers and fails to timely remit the tax to the state.

2. **Key amendments.** The **August 7, 2006 amendments** reduced the proposed penalty from 50 percent to 40 percent. The **June 26, 2006** amendments made nonsubstantive clarifying changes and added a coauthor. The **May 11, 2006 amendments** specified that the proposed penalty shall apply to determinations issued pursuant to specified provisions in the Sales and Use Tax Law. In the previous version of this bill, the proposed penalty would have only applied to determinations issued in cases where the Board is not satisfied with the amount of tax paid with a return or returns filed by taxpayers. These amendments specified that, in addition, the proposed penalty also applies to determinations issued in cases where a person failed to file a return, and in cases where the Board issues a jeopardy determination (these are determinations issued when the Board believes that the collection of the tax will be jeopardized by delay).

The May 2, 2006 amendments specified that the phrase “sales tax reimbursement” shall also include any sales tax that is advertised, held out, or stated to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer. Therefore, a retailer that knowingly fails to timely remit that tax could also be subjected to the proposed 50 percent penalty.

3. **Customers entrust retailers to remit the tax to the State.** Proponents note that sales tax reimbursement or use tax paid to a retailer is generally regarded by customers as “fiduciary taxes” or "trust taxes.” The customers perceive the tax they pay to retailers as the State’s money, not the retailers’. Customers who pay sales tax reimbursement or use tax to a retailer trust and expect the retailer to send it to the state; otherwise they would have no obligation to reimburse or pay the retailer. When sales tax reimbursement or use tax is collected from a customer, the customers’ perception is that the business is, in effect, acting as the agent for the state or local government, collecting the government's money from the customer and then paying it over to the government on a periodic basis. A failure of the business to do so should be subjected to enhanced penalties.
4. **Bill addresses Governor’s veto message of last year’s SB 323.** In his veto message, the Governor indicated that SB 323 provides no flexibility for errors made by individuals with no intent to evade taxes or defraud the state. Unlike SB 323, this measure provides several examples of reasonable circumstances that, if any one of them occurred - or any other reasonable circumstance - that caused the person’s failure to timely remit the tax, the taxpayer would be relieved of the proposed penalty.
5. **Related legislation.** AB 2441 (Klehs) would have imposed a 50 percent penalty for a person’s failure to timely remit sales tax reimbursement or use tax collected. That bill was gutted and amended, and no longer falls under the Board’s purview.

Table of Sections Affected

SECTIONS		BILL AND CHAPTER NUMBER		SUBJECT
Revenue & Taxation Code				
§6248	Amend	AB 1809	Ch. 49	Vehicles, Vessels and Aircraft
§6248	Amend	AB 2239	Ch. 352	Vehicles Brought into California for Repairs
§6360.1	Amend	AB 3076	Ch. 364	Technical Correction – Military Lapel Pin Exemption
§6363.3	Amend	SB 1341	Ch. 373	AIDS/HIV Thrift Store Exemption
§6365	Amend	AB 2533	Ch. 281	Leases of Art Work
§6597	Add	SB 1449	Ch. 252	Penalty for Tax Collected and Not Remitted
Article 1.5 (commencing with §7063) to Chapter 8 of Part 1 of Division 2	Add	AB 1418	Ch. 716	Publication of Top 250 Delinquencies
§7204.3	Amend	AB 1809	Ch. 49	Allocation of Sales and Use Tax Administrative Costs
§7273	Amend	AB 1809	Ch. 49	Allocation of Sales and Use Tax Administrative Costs
Government Code				
§11093.4	Add	AB 588	Ch. 185	Statistical Data - Hollywood
§13292.5	Add Repeal	AB 2591	Ch. 506	State Agencies - Accounts Receivable
§13305	Amend Add Repeal	AB 1809	Ch. 49	Tax Expenditure Reports
Vehicle Code				
§11713.21	Amend	AB 2303	Ch. 567	Car Buyer's Bill of Rights