



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	<a href="#">Chapter 16 of the Fourth Extraordinary Session</a>	Bill No:	<b>ABx4 18</b>
Tax:	<b>Sales and Use</b>	Author:	<b>Budget Committee</b>
Related Bills:	<b>AB 469 (Eng)</b>		

## BILL SUMMARY

Among other things, this 2009/10 budget revision trailer bill requires a qualified purchaser, as defined, to register with the Board and report and pay by April 15, the use tax owed for the previous calendar year. (*Section 6225*)

## ANALYSIS

### CURRENT LAW

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is required to be remitted to the Board on or before the last day of the month following the quarterly period in which the purchase was made, or on the purchaser's state income tax return filed with the Franchise Tax Board. Generally, a use tax liability occurs when a California consumer or business purchases tangible items for their own use from an out-of-state retailer that is not registered with the Board to collect the California use tax.

### PROPOSED LAW

This bill would add Section 6225 to the Revenue and Taxation Code to require "qualified purchasers" to register with the Board and report and pay by April 15, the use tax owed for purchases made during the calendar year. The bill would define "qualified purchaser" as a person that meets all of the following conditions:

- (1) The person is not required to hold a seller's permit.
- (2) The person is not required to be registered pursuant to Section 6226.
- (3) The person is not a holder of a use tax direct payment permit as described in Section 7051.3.
- (4) The person receives at least one hundred thousand dollars (\$100,000) in gross receipts from business operations per calendar year.
- (5) The person is not otherwise registered with the board to report use tax.

This provision would become effective January 1, 2010.

### IN GENERAL

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

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

Therefore, California must rely on purchasers to report their use tax obligations on their out-of-state purchases, such as those made over the Internet or through mail order. And, even though a separate line is currently on the state income tax return with accompanying instructions in the booklet for use tax reporting, the compliance rate remains very low. Unreported use tax is the largest area of noncompliance in California's sales and use tax program - an estimated \$1.2 billion annually is attributable to unreported California use tax by both businesses and individual consumers. For 2008, the Franchise Tax Board processed over 18.5 million returns, yet only 44,114 state income tax returns had use tax reported yielding only \$9 million in state and local use tax revenues.

### COMMENTS

- 1. Entities that would be affected.** Enactment of this bill would essentially apply to all businesses that are not already registered with the Board that have annual gross receipts from business operations in excess of \$100,000. We anticipate approximately 200,000 businesses would fall under this measure's parameters.
- 2. Bill would apply to purchases made during calendar year beginning 2009.** Since the bill would become effective immediately, returns for the reporting of use tax on untaxed purchases made during calendar year 2009 would be due by April 15, 2010. Consequently, without any advance notice of this provision, some businesses may not have kept track of their purchases subject to use tax in their records. Those businesses may have difficulty in accurately determining their correct use tax liability.
- 3. Related Legislation.** AB 469 (Eng), sponsored by the Board, would *require* consumers (including businesses not already registered with the Board, such as those described in this measure) who have failed to report use tax to the Board on their taxable purchases for the preceding year to report the use tax on the income tax returns for the taxable year in which the liability for the qualified use tax was incurred, as specified. Under the AB 469 provisions, however, those taxpayers that are required to be registered with the Board (such as the taxpayers subject to

registration in this bill) would not be allowed to report their use tax liabilities on their state income tax returns.

**COST ESTIMATE**

Significant costs for this provision would be incurred if this bill were enacted. These costs would be attributable to identifying, notifying, and registering all affected businesses, processing an approximate 200,000 additional returns annually, auditing accounts and responding to inquiries. These costs are estimated as follows:

Year	Positions	Amount	Costs	
			General Fund	Local Reimb.
2009/10	123.5	\$13.5 million	\$9.6 million	\$3.9 million
2010/11	124.8	\$10.2 million	\$7.2 million	\$3.0 million
2011/12	126.3	\$10.0 million	\$7.1 million	\$2.9 million
2012/13 and ongoing	137.3	\$11.4 million	\$8.1 million	\$3.3 million

**REVENUE ESTIMATE**

**BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

We examined codes for service enterprises using the North American Industry Classification System against IRS corporate and Schedule C data for calendar year 2007. 1.3 million taxpayers not holding a seller’s permit were identified. Of these taxpayers, less than 30,000 reported gross receipts in excess of \$1 million annually and approximately 160,000 reported between \$100,000 and \$1 million. More than 800,000 taxpayers reported gross receipts of less than \$20,000. Accordingly, a potential of 200,000 accounts would be required to report use tax under the provisions of this bill, and we anticipate that these accounts would represent approximately 95% of the total California business-to-business use tax liability.

We also believe compliance with the provisions of this bill would progressively increase with the Board’s outreach efforts, with about 25% compliance the first year, increasing to 80% compliance in the fourth year and thereafter. The estimate assumes a pattern of business-to-business sales for subsequent years that follows the forecasted percent change in national spending on business equipment and software, according to a leading national macroeconomic forecasting firm. For instance, that forecast assumes that business spending on equipment and structures in 2009-10 will decline by 18 percent, before rebounding (particularly in 2011-12 and 2012-13) as the economy recovers from the current recession.

Finally, the Board implemented the Instate Service Business component of the Tax Gap program in July of 2008. Initial efforts involved (1) sending letters to service industry firms identified as the most likely (based on information from Employment Development Department, Franchise Tax Board and other sources) to have a use tax liability and (2) providing the information resources so that they understand and may choose to comply voluntarily. In cases where voluntary compliance is not obtained, the Board will implement an enforcement program similar to what currently exists under the sales and use tax program. Based on preliminary results of this program, we believe the Board will collect additional use tax revenue amounting to \$70 million annually, absent this provision.

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*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.*

**REVENUE SUMMARY**

	<i>In millions</i>				
	2009-10	2010-11	2011-12	2012-13	2013-14
California Business-to-Business Purchases Subject to Use Tax	\$ 6,861	\$ 7,283	\$ 8,517	\$ 9,722	\$ 10,544
Percent Change from Previous Year	-18.4%	6.2%	16.9%	14.1%	8.5%
Compliance Rate Assumed	25%	40%	60%	80%	80%
Preliminary Use Tax Revenue	151	253	437	665	721
Less Amount Collected by BOE's Tax Gap Program	-70	-70	-70	-70	-70
Net Use Tax Revenue	\$ 81	\$ 183	\$ 367	\$ 595	\$ 651
State General Fund	54	122	245	397	434
State Fiscal Recovery Fund	2	5	10	17	18
Local Funds	25	56	112	182	199

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