

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Alpert Analyst: LuAnna Hass Bill Number: SB 1009

Related Bills: See Legislative History Telephone: 845-7478 Amended Date: April 22, 2003

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Use Tax Administration/Collection By Franchise Tax Board

## SUMMARY

This bill would require the Franchise Tax Board (FTB) to collect certain use tax.

## SUMMARY OF AMENDMENTS

The April 22, 2003, amendments removed the bill's provision that related to an appropriation and replaced it with the provisions discussed in this analysis.

This is the department's first analysis of this bill.

## PURPOSE OF THE BILL

It appears the purpose of this bill is through voluntary compliance to increase general fund revenues by transferring receipt and collection of certain use tax to FTB from the Board of Equalization (BOE).

## EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2004, and be operative for purchases of tangible personal property made on and after January 1, 2004, and on or before December 31, 2009.

## POSITION

Pending.

## ANALYSIS

### STATE LAW

State sales tax is imposed upon retailers for the privilege of selling tangible personal property at retail in this state and is measured by gross receipts.<sup>1</sup> The retailer, however, is entitled to receive reimbursement of these taxes from its customers.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

5/8/03

State use tax is imposed on any person who purchases tangible personal property for use, consumption, or storage in this state. Generally, use tax is applied in instances where the sale is not made in California but the property is purchased for use in California, such as purchases shipped from out-of-state retailers to a California consumer. The state use tax rate is the same as the sales tax rate. BOE is responsible for collecting sales and use tax.

Generally, Pit Income Tax (PIT) returns are filed on a calendar year basis with returns and payments due April 15 following the close of the calendar year, or with an extension the returns are due October 15. PIT or corporation taxes that are not voluntarily paid are subject to various FTB administrative collection actions in order to obtain payment.

### THIS BILL

This bill would allow an individual to elect to report and remit qualified use tax with their PIT return. The election could be made if the individual purchases tangible personal property where the storage, use, or other consumption would subject the purchase to the qualified use tax that would otherwise be required to be reported and paid under current use tax law. A taxpayer who reports qualified use tax with their PIT return would be deemed to have made the election in accordance with this bill. An election to report qualified use tax on the PIT return would be irrevocable. A married individual who files a separate income tax return would be allowed to elect to report on their PIT return either the entire qualified use tax amount or one-half of the qualified use tax owed by the individual and that individual's spouse. If an individual elects to report one-half of the qualified use tax, the election would not be binding on the remaining one-half of the qualified use tax owed by that individual and the individual's spouse.

This bill defines the following terms:

- "Qualified use tax" means use tax imposed on the storage, use, or other consumption of tangible personal property used exclusively for personal purposes within California. The property is brought into California by an individual or shipped to an individual by a retailer outside California. The bill provides specific exemptions from the definition, including an exemption for an individual that has use tax of \$400 or less for a calendar year.
- "Use tax" is defined by reference to the current state and local sales, use, and transaction tax laws.

An individual who elects to report qualified use tax on the state PIT return would be required to report and remit the qualified use tax with a timely filed PIT return. The qualified use tax would be required to be reported on the PIT return for the taxable year in which the qualified use tax was incurred and applies to purchases made on or after January 1, 2004, and on or before December 31, 2009.

This bill would transfer the responsibility and authority for the receipt and collection of use tax that is reported as qualified use tax on a PIT return to the Franchise Tax Board.

Instead of the penalties and interest under current use tax law, qualified use tax that is reported on a PIT return would be subject to the penalties and interest that are applicable to PIT. The penalties and interest would apply in the same amounts and manner as the penalties and interest apply to PIT. Any claims for refund or credits of qualified use tax would be the responsibility of BOE according to current use tax laws. Regardless of whether an individual elects to report and remit qualified use tax on the PIT return, BOE could make determinations for understatements of qualified use tax according to current use tax laws. If an individual elects to report and remit qualified use tax on a PIT return, and the remittance amount is insufficient to satisfy both the PIT liability and the use tax liability, then the remittance amount would be applied to 1) PIT liabilities, 2) PIT penalties and interest, and 3) qualified use tax as reported on the PIT return.

Regardless of the fact that the provision of the bill outlining the reporting of qualified use tax would be repealed December 31, 2009, the other provisions of the bill relating to collection activities attributable to qualified use tax that is reported prior to the repeal date would continue in the same manner as if the provision described above were still in effect.

This bill would provide BOE with statute of limitations language for issuing deficiency determinations regarding individuals who elect to report and remit qualified use tax on the PIT return.

This bill would require FTB to revise the PIT return to allow an individual to report and remit qualified use tax with the PIT return. The revision would be required to be done in a form and manner approved by BOE. FTB would be required to remit the qualified use tax and any interest and penalties, less FTB's costs to administer the qualified use tax, to BOE within 60 days from the date the use tax is received.

### IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion. Additional concerns may be identified as the bill moves through the legislative process. In order for FTB to implement this bill, clarification is needed for at least the following issues, and department staff is available to work with the author's office to resolve these and other concerns that may be identified:

- Under the current tax forms design schedule, the design, printing, and distribution of forms and booklets take place in the fall of the actual taxable year. For example, the design of the 2004 PIT return would begin June 2004, printing would begin October 2004, and distribution of the returns and booklets would begin at the end of 2004. This allows taxpayers to begin reporting and paying their 2004 taxes in January 2005. This bill would require BOE to approve the revision to the PIT tax forms to include the use tax. Such an approval process could delay an already tight forms design schedule.

In addition, it is the author's intent that this bill be operative January 1, 2003, and allow taxpayers to report and remit use tax on the 2003 income tax return. Amendments are attached to change the operative date to purchases on or after January 1, 2003, in taxable years beginning on or after January 1, 2003, which would allow taxpayers to report and remit the qualified use tax on the 2003 returns filed in 2004. However, depending on when this bill were enacted during the 2003 session, it is uncertain if the department would have sufficient time to design the forms accordingly.

- Under this bill, an election to report qualified use tax on the PIT return would be an irrevocable election. Department staff suggests clarifying the term "irrevocable election." Would the election by the taxpayer be irrevocable for that particular PIT return, those particular purchases, or subsequent taxable year PIT returns? Would the election by the taxpayer prohibit the taxpayer from electing to submit use tax to BOE as allowed under current law? Would the individual be allowed to file an amended return to change the reporting of the qualified use tax?

- This bill requires FTB to remit the qualified use tax within 60 days of the receipt of the tax. Assuming the taxpayer self-assesses the use tax on the PIT return, FTB receives PIT returns and payments daily from January through April 15<sup>th</sup> or, with an extension, October 15<sup>th</sup>. It is suggested that the author clarify the remittance language to specify how often FTB should remit the taxes. For ease of administration, the department suggests remitting the funds weekly or monthly, which would have a minor impact on current fiscal operations.
- This bill would require qualified use tax that is remitted to FTB to be applied to PIT tax, penalties, and interest and then the remaining funds applied to the reported qualified use tax. However, it is unclear if the department would be able to apply the funds that were remitted with the return to prior taxable years' income tax debts.

In addition, this bill would allow penalties and interest to apply to the use tax in the same amounts and manner as the penalties and interest apply to PIT. However, the penalties that apply to PIT could generally be seen as irrelevant to the use tax and may discourage taxpayers from electing to report use tax on the PIT return. For example, the underpayment penalty is assessed on an income taxpayer that does not pay their PIT by the due date of the tax return. The delinquent penalty is assessed when the taxpayer does not file their tax return by the due date, and the estimate penalty is assessed when a taxpayer underpays their estimate tax. Would FTB assess an estimate penalty if the taxpayer did not make estimate payments for purchases made during the calendar year? Would FTB assess an underpayment penalty if the use tax is not paid at the time of the filing of the PIT return or assess a delinquent penalty on the use tax amount if the taxpayer does not file their PIT return by the due date?

The author may want to consider allowing the qualified use tax to be reported and remitted on the PIT return in a manner similar to the current voluntary contributions. Generally, FTB collects the voluntary contribution amounts and remits the funds to the proper entity. Interest and penalties do not apply and the voluntary contributions are subject to the current law hierarchy of debt collections.

- Current law provides that sales and use tax returns and payments are due 30 days after the close of the calendar quarter. However, PIT returns are due April 15<sup>th</sup>, or with an extension October 15<sup>th</sup>. The two different due dates for the types of returns may cause confusion for the taxpayer about which date they are required to file by. The author may want to amend the bill to provide that individuals who elect to report qualified use tax on the PIT return would not be subject to the current law due dates and penalties for reporting and filing a use tax return with BOE.
- Current laws regarding the non-tax debts administered by FTB provide for a reimbursement to FTB of costs to administer the programs. The laws are usually specific to the amount of reimbursement available to FTB or require an agreement between agencies outlining reimbursement. The reimbursement language in this bill should be clarified to reflect something similar to existing statutes.

## TECHNICAL CONSIDERATIONS

The department has identified the following technical considerations and amendments are attached.

- Section 6452.1 of the R&TC references Section 7171 of the R&TC. However, the current R&TC does not contain such a section. Amendment 1 is provided to remove the reference to 7171.
- This bill primarily references the California “personal income tax return.” Amendments 2 and 3 are provided to correct erroneous references that refer to the PIT return as the “income return” and “income form.”
- Amendment 6 is provided to remove an unnecessary punctuation.
- After discussion with the author’s staff, the intent is for this bill to be operative for purchases on or after January 1, 2003, in taxable years beginning on or after January 1, 2003. Amendments 4, 5, and 7 are provided to change the operative date accordingly. .

## **PROGRAM BACKGROUND**

To assist taxpayers in becoming aware of the requirement to pay use tax on out-of-state purchases and to aid in voluntary compliance, FTB includes a brief description of the use tax in its PIT booklets. The information explains how to compute the use tax and instructs the taxpayer to send payment and the pertinent information to BOE. For the 2003 filing season, FTB worked in conjunction with BOE to insert a special use tax form and mailing envelope into approximately 3.6 million PIT booklets for 2002.

## **OTHER STATES’ INFORMATION**

A review of the tax forms of the 50 states and a phone survey of six states found that 17 states have a use tax line on the personal income tax return for the 2002 tax year.<sup>1</sup> For these states, the use tax line is an alternative to filing a separate use tax return. All of these states have a single tax agency that is responsible for both income and use tax programs. The following states are representative of the increased reporting that was realized once a line was added to the tax return:

- Michigan collected \$3.1 million from 80,000 returns for the 2000 tax year.
- North Carolina collected \$4.6 million from 169,753 returns for the 2000 tax year.
- Ohio collected \$1.8 million from 57,700 returns for the 2000 tax year.

## **FISCAL IMPACT**

This bill would require a calculation for the sales and use tax that would require significant changes to the tax forms and personal income tax systems. Preliminary cost estimates range from \$1.7 million to \$1.9 million for implementation and from \$600,000 to \$650,000 for on-going costs. These costs include costs resulting from changes to the tax forms, instructions and booklets, processing hours, programming, testing, and maintaining departmental systems, and the development and negotiation of a data exchange with the BOE for the sales and use tax remittance.

<sup>1</sup> Alabama, Connecticut, Idaho, Indiana, Kentucky, Louisiana, Maine, Michigan, Massachusetts, New Jersey, North Carolina, Ohio, Rhode Island, South Carolina, Utah, Vermont, and Wisconsin.

According to the bill, FTB's administrative costs would be deducted from the amounts collected prior to the taxes collected being remitted to BOE. However, no provision is made to cover FTB's start-up costs. To ensure the department has the funding to implement this bill, the department would suggest the author add appropriation language to this bill that would cover the start-up costs of implementation. At a minimum, department staff suggests appropriation language that would provide FTB \$1.3 million the 2003/2004 fiscal year due to the significant tax forms changes and the programming and testing effort required. Absent an appropriation, the department would be required to request a deficiency for the implementation costs. The department is currently working on Budget Change Proposals (BCPs) for the 2004/2005 fiscal year. However, absent an appropriation or Department of Finance approval of a deficiency for 2003/2004 or BCP for the 2004/2005 fiscal year, the department would be required to redirect staff from other revenue generating activities of the department, such as collections administration or audit, to administer this bill.

### **ECONOMIC IMPACT**

This bill would have no identifiable revenue impact under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL). Collection of sales and use tax revenue is a function of BOE, which has both the data and expertise in this area. Accordingly, FTB staff defers the revenue estimate for this bill to BOE.

### **ARGUMENTS/POLICY CONCERNS**

It is the author's intent that this bill be operative for purchases on or after January 1, 2003, in taxable years beginning on or after that date, and to allow taxpayers to report and remit use tax on the 2003 income tax return, which is filed in 2004. Depending on when this bill may be enacted this year, taxpayers may not have been keeping adequate records or receipts of purchases during 2003 that are subject to the use tax and could be reported on the PIT return for 2003.

This bill could be viewed as providing an inequitable reporting election for certain classes of taxpayers. For example, the use tax reporting election under this bill would not be required of those individual taxpayers who have less than \$400 of use tax owing or to any partnerships, corporations, or other business entity taxpayers. Excluding these taxpayers could limit the revenue gain the state could otherwise experience by including these taxpayers since these entities may have a greater use tax liability than individuals.

Current laws regarding the non-tax debts administered by FTB provide for a reimbursement to FTB of costs to administer the programs. The laws are usually specific to the amount of reimbursement available to FTB or require an agreement between agencies outlining reimbursement. Although the reimbursement could be based on a percentage of collections, concern has arisen when the department contracts for a percentage of collection to cover costs because the possibility exists that the percentage may not cover the costs of the program in any given year and monies from the General Fund may be needed to cover any difference.

This bill is unclear whether the reporting and remitting of qualified use tax is considered a use tax return under the sales and use tax laws. The author may want to amend the bill to provide that electing to report and remit qualified use tax on the PIT return is considered a use tax return for purposes of the sales and use tax laws.

Under this bill, administrative functions regarding the use tax would be divided. FTB would administer and collect use tax reported on the PIT return. However, BOE would retain responsibilities for auditing, collecting, and processing claims for refund of the use tax. The author may wish to ensure that BOE systems are able to accept the additional taxpayer data that FTB would provide regarding the taxpayer and the use tax data. In addition, the separation of functions may cause confusion for the taxpayer.

#### **LEGISLATIVE STAFF CONTACT**

LuAnna Hass  
Franchise Tax Board  
845-7478  
[LuAnna.Hass@ftb.ca.gov](mailto:LuAnna.Hass@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
845-6333  
[Brian.Putler@ftb.ca.gov](mailto:Brian.Putler@ftb.ca.gov)

Analyst LuAnna Hass  
Telephone # 845-7478  
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 1099  
As Amended April 23, 2003

AMENDMENT 1

On page 2, line 4, strikeout "and 7171"

AMENDMENT 2

On page 3, line 7, strikeout "income return" and insert:  
income tax return

AMENDMENT 3

On page 4, line 32, strikeout "income form" and insert:  
income tax return

AMENDMENT 4

On page 5, line 10, strikeout "January 1, 2004" and insert:  
January 1, 2003, in taxable years beginning on or after January 1, 2003,

AMENDMENT 5

On page 6, line 37, strikeout "January 1, 2004," and insert:  
January 1, 2003,

AMENDMENT 6

On page 7, line 3, strikeout "shall, revise the" and insert:  
shall revise the

AMENDMENT 7

On page 7, line 38, strikeout "January 1, 2004" and insert:  
January 1, 2003,