

BILL ANALYSIS

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| Department, Board, Or Commission Franchise Tax Board | Author Assembly Revenue and Taxation Committee | Bill Number AB 2758 |
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SUBJECT

Change Use Tax to First Priority for Taxes Paid on Franchise Tax Board (FTB) State Tax Returns

SUMMARY

This bill would modify the priority of payments related to use tax reported on the tax return.

REASON FOR THE BILL

The reason for this bill is to eliminate the need for the Board of Equalization (BOE) to initiate billing and collection activity for taxpayers that made their use tax payments on their return filed with the FTB, but the payments were instead used to reduce state income tax liabilities.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2015, and specifically apply to purchases of tangible personal property made on or after January 1, 2015, in taxable years beginning on or after January 1, 2015.

STATE LAW

The BOE is responsible for collecting sales and use tax. California use tax is imposed on any person who purchases tangible personal property for use, consumption, or storage in this state where the purchase is not subject to California sales tax. Generally, use tax is owed when the purchase is made outside of California, and the property is used in California. A typical purchase subject to California use tax is a purchase shipped from an out-of-state retailer to a California consumer. The state use tax rate is the same as the sales tax rate that varies depending on the county and city within California in which the taxpayer resides.

Taxpayers may elect to report and pay state use tax directly to the BOE or report and pay use tax on their California individual, corporation, partnership, limited liability company, fiduciary, or exempt organization return. For taxpayers that elect to report and pay their use tax on these returns, current state law requires payments and credits to be applied first to the FTB tax liability, if any, and any remaining balance is then applied towards the use tax reported on the return and transferred along with any necessary information to the BOE.

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| Gail Hall, FTB Contact Person (916) 845-6333 (Office) | Executive Officer Selvi Stanislaus | Date 08/29/14 |
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THIS BILL

This bill would remove the provision that requires the payments or credits, on an income tax return of a person who reports use tax, to first apply to satisfy any FTB outstanding taxes, penalties, or interest for the current and prior years. Instead, the FTB would first apply the amount of payments or credits available¹ to satisfy the reported use tax, with any excess amount then being applied to the outstanding income taxes, penalties, or interest owed to the FTB.

LEGISLATIVE HISTORY

SB 86 (Committee on Budget and Fiscal Review, Chapter 14, Statutes of 2011) among other things, allows a person that meets the requirements to report the use tax liability by using a use tax table shown in the instructions for the individual tax return or by reporting the actual use tax due. In addition, this law precludes the BOE from making any determinations for understatements of use tax against any person with qualified purchases who utilizes the use tax table in accordance with the accompanying instructions.

SB 858 (Committee of Budget and Fiscal Review, Chapter 721, Statutes of 2010) among other things, reauthorized and made permanent the option for taxpayers to report use tax on their personal income or corporation tax returns.

OTHER STATES' INFORMATION

The states surveyed include *Florida, New York, Illinois, Massachusetts, Michigan, and Minnesota*. These states were selected due to their population and similarities to California's economy, business entity types, and tax laws.

Florida uses a separate sales and use tax return.

New York, applies credits to use tax before income tax.

Minnesota uses a separate sales and use tax return.

No information was located for *Illinois, Massachusetts, and Michigan*.

FISCAL IMPACT

Staff estimates a one-time cost of approximately \$258,000 to develop, program, and test revisions to the department's accounting and collection systems.

¹ Including any other credits associated with that person's tax year.

ECONOMIC IMPACT

Revenue Estimate

| Estimated Revenue Impact of AB 2758* Assumed Enactment After June 30, 2014 | | |
|---|-------------|-------------|
| 2014-15 | 2015-16 | 2016-17 |
| n/a* | - \$60,000* | - \$50,000* |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

*This estimate reflects only the loss of transfer of funds to the General Fund from the FTB as not all tax debts are collected. It does not include gains to various state and local funds administered by the BOE.

Revenue Discussion

Tax return data from the 2011 and 2012 taxable years show that over \$20 million in use tax was reported on state tax returns in each year. However, the average amount of combined use tax and income tax actually paid over the two years fell short of the total amount of combined tax due by over \$1 million in each year. Because payments were applied to income tax liabilities before use tax liabilities, the annual shortfall became part of the BOE’s accounts receivable balance and was subject to BOE’s collection program.

Under this bill, instead of the BOE having to collect on the shortfall in use tax, the FTB would now apply the entire payment to use tax and collect on any shortfall of income tax liability payments.

Using historical collection data, it is estimated that the department will collect 95 percent of the annual income tax shortfall in tax return payments over several years. Estimated collections are then accrued back one year. The net result is a revenue loss of \$60,000 in 2015-16, with losses declining thereafter as shortfall collections start to offset a greater portion of shortfall losses in subsequent years.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

VOTES

| | Date | Yes | No |
|----------------|-------------|------------|-----------|
| Concurrence | 08/27/14 | 78 | 0 |
| Assembly Floor | 05/23/14 | 73 | 6 |
| Senate Floor | 08/26/14 | 34 | 0 |

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