

Date of Hearing: June 20, 2016

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Sebastian Ridley-Thomas, Chair

SB 898 (Nguyen) – As Amended May 31, 2016

Majority vote. Fiscal committee.

SENATE VOTE: 39-0

SUBJECT: Sales and use taxes: exemption: animal blood

SUMMARY: Establishes a sales and use tax (SUT) exemption for animal whole blood, plasma, blood products, and blood derivatives, sold by a nonprofit animal blood banking business for use in the cure, mitigation, treatment, or prevention of injury or disease in animals pursuant to Food and Agricultural Code Section 9241. Specifically, **this bill:**

- 1) Contains legislative findings noting that animals have emergencies and illnesses that present a critical need for blood products, and that it is in the public interest to relieve from liability those nonprofit animal blood banking businesses that have not paid sales tax or collected sales tax reimbursement on their sales of animal blood products, thereby preventing undue hardship on those nonprofit animal blood banking businesses that offer this vital life service.
- 2) Directs the State Board of Equalization (BOE) to cancel any notice of determination and any related penalties and interest, and not to issue any future notices, with respect to sales of animal whole blood, plasma, blood products, and blood derivatives, sold by a nonprofit animal blood banking business for use in the cure, mitigation, treatment, or prevention of injury or disease in animals pursuant to Food and Agricultural Code Section 9241.
- 3) Contains legislative findings that the cancellation of existing BOE notices of determination serves a public purpose and does not constitute a gift of public funds within the meaning of Section 6 of Article XVI of the California Constitution.
- 4) Provides that, notwithstanding existing law, the state shall not reimburse cities and counties for any SUT revenues lost by them under this bill.

EXISTING LAW:

- 1) Imposes a sales tax on retailers for the privilege of selling tangible personal property (TPP), absent a specific exemption. The tax is based upon the retailer's gross receipts from TPP sales in this state.
- 2) Imposes a complimentary use tax on the storage, use, or other consumption of TPP purchased out-of-state and brought into California. The use tax is imposed on the purchaser; and unless the purchaser pays the use tax to an out-of-state retailer registered to collect California's use tax, the purchaser remains liable for the tax. The use tax is set at the same rate as the state's sales tax and must generally be remitted to the BOE.

- 3) Provides that human whole blood, plasma, blood products, and blood derivatives, or any human body parts held in a bank for medical purposes, are exempt from taxation for any purpose. (Revenue and Taxation Code (R&TC) Section 33).
- 4) Exempts from SUT any container used to collect or store human whole blood, plasma, blood products, or blood derivatives that are exempt from taxation under R&TC Section 33, including blood collection units and blood pack units. (R&TC Section 6364.5).
- 5) Prohibits any person from offering for sale or use any of the following:
 - a) Any biologic unless it is manufactured pursuant to the terms of a valid license or permit issued by the United States Department of Agriculture; or,
 - b) Any blood or blood component product unless it is produced in a licensed establishment. (Food and Agricultural Code Section 9241).

FISCAL EFFECT: Unknown. The BOE notes that this bill would result in annual state and local SUT revenue losses of \$78,980. This amount, however, does not include any unpaid liabilities that this bill would direct the BOE to relieve. BOE staff notes that, at present, this bill would only apply to one taxpayer in the state of California. The author's office, in turn, has provided documentation showing a SUT liability for this single taxpayer of \$81,830.27 for the period from January 1, 2008 to June 30, 2011. In addition, the BOE's Report of Field Audit disclosed interest of \$23,428.71 through July 31, 2014. Thus, assuming these amounts have not been paid, this bill would result in a one-time loss of at least \$105,258.98 for past due taxes and interest.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

Senate Bill 898 amends the California Revenue and Taxation [C]ode to clarify that the sale and use of animal blood, blood products, and derivatives by a licensed CDFA-licensed nonprofit animal blood bank are not subject to tax when sold for use in the cure, mitigation, treatment or prevention of injury or disease in animals.

Animal blood banks serve an important role in saving the lives of animals that are in need of surgical procedures. Human blood banks, such as the American Red Cross, enjoy a similar exemption, partly in recognition that human blood banks help save lives. This same exemption does not apply to nonprofit animal blood banks.

SB 898 will help ensure that animal blood banks continue to be treated under the law the same as human blood banks.

- 2) This bill is supported by the Humane Society Veterinary Medical Association, which notes the following:

Historically, human blood transfers have been exempt from sales and use tax. However, it has been unclear whether sales and use tax applies to the sales of animal blood products. SB 898 amends the California Revenue and Taxation [C]ode, clarifying that

transfers of animal blood by licensed non-profit animal blood banks are not subject to these taxes.

We urge all of your colleagues in the Legislature to join in support of this commonsense bill which will help safeguard (1) the viability of nonprofit California animal blood banks providing essential resources to veterinarians statewide, (2) the health and well-being of our companion animal patients, and (3) the peace of mind of their human family members who love them.

- 3) This bill is opposed by the California State Association of Counties, which notes the following:

After the past thirty years of changes to sales and use tax allocations, counties now receive almost half of sales and use tax revenues. About two-thirds of that revenue is constitutionally dedicated to providing local public safety services and federal and state programs, including social services, incarceration, and rehabilitation. Unfortunately, SB 898 would erode an important revenue source for counties. The total estimated losses could be considered minor when compared to the State budget. For counties, though, the combined potential losses proposed in the current legislative session are not insignificant.

More troubling than the direct revenue losses is the forgiveness provision in SB 898 for unpaid sales and use tax liabilities from prior years. This represents further losses and a troubling possible precedent for other sales and use tax exemptions.

- 4) The BOE notes the following in its staff analysis of this bill:
- a) Effect of the bill: "Nonprofit licensed animal blood banks will not be required to report sales or use tax on their sales of animal blood products when those sales are for the cure, mitigation, treatment or prevention of injury or disease in animals. In addition, they will be relieved of liability for any unpaid sales and use tax related to these sales."
 - b) "Nonprofit animal blood banking business" should be defined: "California currently has one nonprofit licensee; however, for purposes of clarity, the bill should define "nonprofit." For example, an appropriate definition, such as "an organization that qualifies for tax-exempt status under section 501(c)(3) of the Internal Revenue Code" would suffice."
 - c) This bill does not materially impact the BOE's tax audit or administrative functions: "Since this bill applies to one nonprofit licensed animal blood bank that currently exists in California, this bill would not materially impact the BOE's administrative responsibilities."

- 5) Committee Staff Comments

- a) What is a "tax expenditure"? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone

revenues).

- b) How is a tax expenditure different from a direct expenditure? As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are reviewed less frequently than direct expenditures once they are put in place. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.
- c) An overview of the SUT Law: California's SUT Law imposes a sales tax on retailers for the privilege of selling TPP, absent a specific exemption. The tax is based upon a retailer's gross receipts from TPP sales in California. The SUT Law also imposes a mirror "use tax" on the storage, use, or other consumption of TPP purchased out-of-state and brought into California. The use tax is imposed on the *purchaser*, and unless the purchaser pays the use tax to an out-of-state retailer registered to collect California's use tax, the purchaser remains liable for the tax. The use tax is set at the same rate as the state's sales tax and must generally be remitted to the BOE.

The SUT represents the state's second largest source of General Fund (GF) revenues. Nevertheless, the past 60 years have seen a dramatic reduction in the state's reliance on the SUT and a corresponding increase in its reliance on personal income tax revenues. In fiscal year (FY) 2014-15, SUT revenues were estimated to comprise 23% of the state's GF revenues, down from nearly 60% in FY 1950-51.

- d) What accounts for the state's reduced reliance on SUT revenues? The SUT Law was enacted in a very different era. In the 1930s, California's economy was largely dominated by manufacturing, and residents mostly bought and sold tangible goods. Thus, in establishing the base for a new consumption tax, it made sense to impose the tax on sales of TPP, defined as personal property that may be "seen, weighed, measured, felt, or touched." Over the past 80 years, however, California's economy has seen dramatic growth in the service and information sectors, resulting in a significant erosion of the SUT base. For example, the Commission on the 21st Century Economy noted that spending on taxable goods represented 34.6% of personal income in 2008, down from 55.4% in 1980. As a result, tax experts and economists from across the political spectrum argue that California should expand its SUT base.

It could be argued that, while well-intentioned, additional SUT exemptions further erode an already shrinking SUT base. This, in turn, increases fiscal pressures to maintain or even increase California's relatively high SUT rate. High rates arguably promote non-compliance and encourage out-of-state purchases, placing California retailers at a competitive disadvantage. High rates also risk impacting consumer decision-making, which runs counter to widely accepted principles of sound tax policy.

- e) What would this bill do? This bill would provide a complete SUT exemption for animal whole blood, plasma, blood products, and blood derivatives, sold by a nonprofit animal

blood banking business for use in the cure, mitigation, treatment, or prevention of injury or disease in animals.

The BOE notes that, according to the California Department of Food and Agriculture, there are two California animal blood bank establishments with licenses to produce, market, and sell animal blood and products. These facilities provide whole blood, plasma, platelets, and clotting factors to veterinary hospitals and clinics. The blood used to make these products is collected from the animal "blood donors" housed permanently or semi-permanently at the blood bank. The BOE notes that, under California law, pet owners are not allowed to volunteer their animals as donors to these commercial blood banks.

The BOE notes that, of the two licensed animal blood banks in California, only one of them operates as a nonprofit business. Thus, it would appear that this bill is designed to provide relief, through a complete SUT exemption, to a single entity. The Committee may wish to consider the policy implications of providing such preferential treatment to one taxpayer.

In addition, this bill would direct the BOE to cancel any notice of determination, along with related penalties and interest, associated with this taxpayer's past sales. Generally, tax expenditure programs are implemented to encourage future taxpayer behavior and not to provide retroactive relief. This bill may establish a precedent for future legislation in cases where a tax liability is discovered through audit, and the taxpayer seeks to escape payment by having legislation introduced to compel the cancellation of their underlying liability.

To the extent this Committee desires to provide retroactive relief, it may wish to make the relief contingent upon a BOE finding that the taxpayer did not collect sales tax reimbursement on its past sales.

- f) Absence of a sunset date: In its current form, this bill's proposed tax expenditure lacks an automatic sunset provision. This Committee has a longstanding policy favoring the inclusion of sunset dates to allow the Legislature periodically to review the efficacy and cost of such programs. The author may wish to consider the addition of an appropriate sunset provision.

REGISTERED SUPPORT / OPPOSITION:

Support

American Holistic Veterinary Medical Association
California Veterinary Medical Association
Hemopet/Hemolife
Humane Society Veterinary Medical Association
State Board of Equalization Member George Runner

Opposition

California State Association of Counties

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