

The Contemporary Tax Journal

Volume 11
Issue 1 *The Contemporary Tax Journal Volume*
11, No. 1 – Winter 2022

Article 7

2-2-2022

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Recommended Citation

Karelia, Pooja CPA and Partani, Sheetal EA (2022) "California AB 1121, Sales Tax Exemption Emergency Preparation Items," *The Contemporary Tax Journal*: Vol. 11 : Iss. 1 , Article 7.
<https://doi.org/10.31979/2381-3679.2022.110107> <https://scholarworks.sjsu.edu/sjsumstjournal/vol11/iss1/7>

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California AB 1121, Sales Tax Exemption Emergency Preparation Items

By: Pooja Karelia, CPA and Sheetal Partani, EA

Introduction

On February 18, 2021, California Assembly Member Rodriguez (D-52) introduced AB-1121, Sales and Use taxes: exemptions: emergency preparation items.¹ The proposal was referred to the Committee on Revenue and Taxation on March 4, 2021 but was not acted upon in 2021. This bill aims to provide an exemption from sales taxes for the sale of, and the storage, use, or other consumption of emergency preparation items, as defined, sold or purchased during the 3-day period beginning at 12:01 a.m. on the Saturday before the last Monday in June and ending at midnight on the last Monday in June. Thus, this bill would create a “sales tax holiday” which would be the first one in California.² This bill is proposed as a temporary provision for the period January 1, 2022, to January 1, 2024.

There is no limit on the number of items that can be purchased, however there is a limit on the dollar amount of the items. The proposal specifies 12 items which would be exempt, divided into two parts namely a portable generator up to \$1,500 and 11 other types of products which have a sale price under \$75.

California cities and counties generally conform to the state sales and use tax law. Amendments such as the proposed bill, are automatically incorporated into the local tax law. Currently the California State law requires the state to reimburse counties and cities for loss of revenue caused by enactment of exemptions however this proposal explicitly provides that no appropriation would be made, and the state would not be required to reimburse any local agencies for sales and use tax revenues lost by this new sales tax holiday.

AB-1120 Sales and Use tax: exemption: disaster preparedness products which was introduced by Assembly Member Tran on February 23, 2007, which was similar in purpose to the current bill. In the comment section of the bill, the sponsors stated that "Sales tax holidays are popular with consumers and retailers in other states. By targeting goods that are useful in the event of a disaster AB 1120 would encourage preparedness and self-reliance of Californians while giving retailers that supply these goods the ability to offer these products at a lower cost to consumers."³

¹ AB 1121-Sales and Use taxes: exemptions: emergency preparation items

https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220AB1121.

² Many states have various types of sales tax holidays; see <https://taxfoundation.org/2021-sales-tax-holiday>.

³ AB 1120 Sales and Use taxes: exemptions: disaster preparedness products (2007-08) Bill Analysis section, report on 01/11/08 Assembly Revenue and Taxation – comments section -

https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=200720080AB1120.

This section analyzes California AB 1121, Sales Tax Exemption Emergency Preparation Items using the twelve principles set out in the AICPA’s Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals.⁴

Principles of Good Tax Policy Worksheet

Criteria	Does the proposal satisfy the criteria? (explain)	+/-
<p><i>Equity and Fairness</i> – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</p>	<p><i>Horizontal equity:</i> Horizontal equity requires similarly situated taxpayers to be taxed similarly. This proposal exempts certain items from sales tax during a three-day window in June for years 2022 and 2023. This practice is quite common and many states like Florida,⁵ Texas, Louisiana have almost similar provisions for emergency/disaster preparedness items. However, this proposal favors selected products relative to other products. One can argue that various items like axes, pocketknives, handwarmers, ladders, blankets, tents, bug repellants, etc., are also useful in emergencies⁶. There is no exemption for these items (states like Texas⁷ exempt axes as well as emergency ladders). The sales tax exemption is available only during the three-day period and not during other days, encouraging people to stock up during such time.</p> <p><i>Vertical equity:</i> The vertical equity principle is satisfied when taxpayers with higher income pay more tax than taxpayers with lower income. There is no phase out/limitations for higher earning taxpayers. The taxpayers with higher income would get the same amount of exemption as taxpayers with a lower income. There is some debate whether higher income individuals really need a sales tax exemption and whether it is fair to distribute the burden of that tax expenditure on all the taxpayers. Generally, because high-income taxpayers have more resources available to purchase emergency preparedness</p>	<p>-</p>

⁴ American Institute of Certified Public Accountants (AICPA) Tax Division. (January 2017). Tax Policy Concept Statement 1 - Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals; available at: <https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>.

⁵ Florida Disaster Prepared Sales tax holiday <https://floridarevenue.com/DisasterPrep/Documents/2021DPposter.pdf>.

⁶ Information on survival kit requirements <https://www.redcross.org/get-help/how-to-prepare-for-emergencies/survival-kit-supplies.html>.

⁷ Texas Emergency Preparation Supplies Sales Tax Holiday, See Section “Less than \$300” and “Less than \$75” <https://comptroller.texas.gov/taxes/publications/98-1017.php>.

	<p>items, they will get a greater benefit of the sales tax exemption assuming they spend more money on such items. Since the exemption treats all consumers equally regardless of their income levels, it violates the principle of vertical equity.</p>	
<p><i>Certainty</i> – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?</p>	<p>The proposed bill includes a detailed description of when the sales tax would be exempt, which products would be exempt and for how many years will this provision exist (unless extended). The proposal is uncomplicated with basic requirements and no complex exemptions. The items listed in the provision are general and widely used items. There is little scope of interpretation. For example, portable, self-powered light sources include lanterns, candles, flashlights etc.</p> <p>Also, it does not require special forms or additional reporting. The overall confidence for compliance is high because of its simplicity and easy to follow requirements. This proposal meets the principle of certainty. However, the bill is unclear about the benefit, if any, when eligible items are purchased online and the vendor charges sales tax.</p>	+
<p><i>Convenience of payment</i> – is the tax due at a time that is convenient for the payor?</p>	<p>This proposal does not add any burden of payment on the consumer or sellers. On the contrary this bill is about the exemption of certain items. The taxpayers do not need to make a payment and vendors are not required to collect any tax. This proposal does not affect the principle of convenience of payment.</p>	N/A
<p><i>Effective Tax Administration</i> – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.</p>	<p>As a whole, the cost to comply with this proposal would be reasonable for both the government and the taxpayers. At present, Section 2230 of Revenue and Taxation Code requires that California state reimburse counties and cities for the revenue losses caused by the enactment of sales and use tax exemption. The reimbursement shall be made when funds have been appropriated. However, it is provided in the bill that no appropriation is made, and the California state government would not reimburse any local agencies for sales and use tax revenues lost by them pursuant to this bill, notwithstanding Section 2230 of Revenue and Taxation Code.</p> <p>The vendors of the specified emergency preparedness items need to be aware of the temporary provision of exemption for three-day period and will need to take</p>	+

	<p>necessary steps to ensure compliance. Since the list is quite specific and has dollar amount limitations, it should not be too burdensome to identify and track the exempt items. Yet, there will be costs of this additional recordkeeping and high risk of error. Today, sophisticated sales software can help identify and track the exempt items for a specified time in a cost-efficient manner. For smaller business owners this might include additional efforts but overall, it could be a manageable burden. So, this proposal mostly meets the principle of Effective Tax Administration.</p>	
<p><i>Information Security</i> – Will taxpayer information be protected from both unintended and improper disclosure?</p>	<p>The bill does not require any additional reporting or disclosures. The exemption of sales tax on the emergency preparation items does not require any taxpayer to have an exemption certificate or additional information reporting by the seller in the tax forms. So, there is no additional risk of unintended or improper disclosure of taxpayer information. The bill is neutral to the principle of information security.</p>	<p>N/A</p>
<p><i>Simplicity</i> - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</p>	<p>The proposal is short and concise. It does not require any special calculations to be made. There is a list with 12 types of items which are exempt from sales tax during the three-day period. The list states the dollar amount and any other specifications for the 12 types of items. (e.g., \$1,500 limit for the portable generator and \$75 limit for the remaining 11 items). The only thing that would be required is for the sellers to not collect tax during this period. There are no additional forms, receipts or supportive documents required. Given the sophistication of widely used billing and sales software, this can be easily managed by medium and large businesses. For small businesses with limited/no software and hardly any tax professional consultation, there will be an additional effort to understand the change and earmark the products which will be exempt from sales tax during the proposed three-day period. However, all in all this proposal is straightforward and taxpayers would be able to comply with this proposal in a cost-efficient manner. Thus, this proposal mostly meets the principle of simplicity. There might be some issues of properly identifying the eligible items.</p> <p>Vendors will have special reporting to separate out the exempt items sold during the three days and keep good records to ensure they did this correctly.</p>	<p>+</p>

<p><i>Neutrality</i> - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>The proposal may result in government influencing consumers to change when they purchase goods. It might not be wise idea for the consumers to wait until the 3-day period mentioned in the bill. It might not be true in all the situations. For example, it might not be a good idea to wait until the weekend before school begins to buy school supplies. For others it might be wiser to wait until the weekend to take the benefit of the bill (sales tax exemption on certain items.). This kind of proposal might affect consumer timing decisions. In addition, consumers may engage in tax planning and take advantage of the sales and use tax exemption during the mentioned period in the bill. This bill does not support principle of neutrality because it favors consumers in picking products and industries to favors with sales and use tax exemptions. This bill discriminates among the products and across the time and alter consumer decisions.</p>	<p>-</p>
<p><i>Economic growth and efficiency</i> – will the tax unduly impede or reduce the productive capacity of the economy?</p>	<p>This bill would be beneficial to the consumers and provide relief to those who are adversely impacted and who are in need of these emergency supplies. This exemption provides some relief to low-income individuals, whereas this kind of sales tax exemption gives unexpected benefit to high income earners. This bill does not promote economic growth or significantly increase consumer purchases. The 2017 study by the Federal Reserve found that this kind of exemption simply shifts the timing of purchases without necessarily increasing spending.⁸ It is possible that some retailers will increase prices of the products during the 3-day holiday period, thereby reducing consumer savings. This bill provides an exemption for certain items, but not for others which might also be required for emergency situations. This proposal favors particular products, thereby causing capital to flow to particular products mentioned in the bill. This can harm other industries. This bill does not provide a significant boost to the economy.</p> <p>Similar bill in different states have faced difficulties and some states and localities had to cancel or opt out their</p>	<p>-</p>

⁸ Aditya Aladangady, et al, “The Effect of Sales-Tax Holidays on Consumer Spending,” *FEDS Notes*, Mar. 24, 2017; <https://www.federalreserve.gov/econres/notes/feds-notes/effect-of-sales-tax-holidays-on-consumer-spending-20170324.htm>.

	<p>sales tax holidays. “The District of Columbia Office of Taxation and Revenue estimated that it would save \$640,000 in tax revenue by canceling its sales tax holiday in 2009.⁹ North Carolina officials found that repealing their sales tax holiday in 2013 would save the state \$16.3 million the next year, and put those dollars toward individual and corporate income tax cuts.¹⁰ Experts from the sales tax industry and economists agree that there is little evidence of increased economic activity as a result of temporary sales tax exemptions (popularly called sales tax holidays).¹¹</p>	
<p><i>Transparency and Visibility</i> – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?</p>	<p>It is more likely that consumers can get information about the bill from the California CDTFA website itself. The other states with a similar bill have been updating the website with instructions and a detailed list of products that are eligible for the exemption. There is high possibility that consumers might miss out on the details of the eligible product list without an official campaign to create awareness of exemption. Moreover, providing sales and use tax exemption only for particular products listed in the bill might be misleading and businesses may be demotivated if they are selling the products which are also essentials, and this exemption does not apply to their business. It is also likely the vendors will provide the advertising needed to be sure consumers are aware of the holiday.</p>	<p>+/-</p>
<p><i>Minimum tax gap</i> – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or</p>	<p>The likelihood of this bill causing non-compliance is low as vendors will be motivated to properly comply to avoid any liability to themselves and to help sell products. It is not clear why only a few items are listed in the essentials list whereas other items like handwarmers, ladders, blankets, tents, bug repellants etc. are also useful in emergencies. But this bill includes the detailed list of items that fall under the sales tax exemption. The items listed are widely used</p>	<p>+</p>

⁹ See, e.g., Micah Cohen, “A True Cause for Celebration: DC Cancels Sales Tax Holiday,” Tax Foundation Tax Policy Blog, July 22, 2009, [See, e.g., Micah Cohen, “A True Cause for Celebration: DC Cancels Sales Tax Holiday,” Tax Foundation Tax Policy Blog, July 22, 2009, https://taxfoundation.org/blog/a-true-cause-for-celebration-dc-cancels-sales-tax-holiday/](https://taxfoundation.org/blog/a-true-cause-for-celebration-dc-cancels-sales-tax-holiday/).

¹⁰ Sandra Johnson, Jonathan Tart, and Brian Slivka, “House Bill 998, 5th edition” (2013 sess.), Legislative Fiscal Note, North Carolina General Assembly Fiscal Research Division, July 2, 2013. <http://www.ncleg.net/Sessions/2013/FiscalNotes/House/PDF/HFN0998v5.pdf>.

¹¹ See, e.g., David Brunori, “The Politics of State Taxation: Dumber Than a Bag of Hammers,” 2001 State Tax Notes 48-63, Mar. 12, 2001. After listing many of the flaws of sales tax holidays and citing scholars on the left and right, Brunori colorfully writes that sales tax holidays are “dumber than a bag of hammers.”

<p>unintentionally avoid or evade this tax or rule?</p>	<p>during emergencies. There are no further regulations required and there is very little scope of consumers making errors caused by confusion and uncertainty. This bill meets this principle</p>	
<p><i>Accountability to taxpayers</i> – Do taxpayers have access to information on tax laws and their development, modification, and purpose; is the information visible?</p>	<p>The local and state government should release guidance and inform consumers regarding developments in the tax code. Taxpayers will understand the purpose of the bill as well as the qualifications for the sales tax exemption as this exemption is for the essentials required during emergency situations. The government must publish the data which can be readily made available to the taxpayers.</p> <p>There have been many bills and alternatives of the similar bill in various states that have been proposed in the past and are publicized through national news and there have been lots of articles and posts on Twitter. Not all the bills catch the public’s attention tough. It is not likely that most consumers know that the exemption exists unless they regularly follow the news channel and social media like Twitter. It is likely that consumers might not know that only a few listed items are exempt from the sales tax. It is not likely that the average person knows about this bill. Some consumers may assume that it is a bill for all the essentials required during emergencies. Consumers likely will not understand why some items are exempt and others are not and why the exemption only applies for a three-day period.</p>	<p>-</p>
<p><i>Appropriate government revenues</i> – will the government be able to determine how much tax revenue will likely be collected and when?</p>	<p>There are similar bills passed in different states and the data is available that would help the California government to approximately determine how much tax revenue will not be collected during the holiday. Most of the states have prompted and have opted out of such sales tax exemption bill. For example, the District of Columbia has estimated the savings of \$640,000 in tax revenue by cancelling its sales tax holiday in 2009. There was a similar bill in California (AB 1120)¹²-Sales tax: exemptions: disaster preparedness products in the year 2008. BOE staff estimated that retailers would incur approximately \$9.3 million cost to implement the change in price again. Hence from the past bills from the State of California and using the data from the other state’s government, determining tax revenues can easily be determined.</p>	<p>+</p>

¹² https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=200720080AB1120.

Conclusion:

AB 1121 should be reevaluated. Rather than providing tax cut or boost to the economy, this bill is likely to impose costs on consumers and businesses without providing sufficient benefits. To achieve the goal of this bill the sales tax exemption should be neutral towards the products and timing decisions; all the products required during emergency should consistently be subject to the same sales tax rate. The sales tax exemption will benefit buyers of the proper products during the three-day period but also provide benefit to people who would have purchased these products anyway. Also, if these products are so important to all individuals, why are they only lower cost (assuming vendors don't increase prices during the holiday) only for three days of the year?

This bill likely does not contribute to economic growth or increase purchases. The funds lost during the holiday could instead be spent on publicity and buying supplies for low-income households. This bill in general does not provide expected tax relief to the low-income individuals, but provide larger tax savings to the high-income individuals.

Suggested Improvements:

1. If a purchase is made during the holiday period and is exchanged for another item after the holiday period, the exemption would not apply to the new item, thereby causing potential confusion and reporting errors. The bill should include a provision regarding return/exchange of items.
2. Also such exemptions set precedents for future exemptions, there should be a proper study conducted to understand whether such tax holidays change the consumer behavior or simply subsidize existing behavior.
3. Non-tax solutions should be pursued to meet the intended goal of ensuring more people have emergency supplies such as providing them to low-income households.