



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	01/07/08	Bill No:	<u>AB 21</u>
Tax:	Sales and Use	Author:	Jones
Related Bills:			

BILL SUMMARY

This bill would, among other things, provide that it shall be rebuttably presumed that, except as specified, a vessel purchased outside this state and brought into California within 12 months from the date of purchase is purchased for use in California and is subject to California use tax.

ANALYSIS

CURRENT LAW

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed 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, or in the case of a vehicle or undocumented vessel, to the Department of Motor Vehicles.

Existing law provides that if a vehicle, vessel, or aircraft is purchased outside California and is first functionally used outside California but enters the state within the first 90 days of purchase (commonly referred to the “90-day test”), the vehicle, vessel, or aircraft is presumed to have been purchased for use in California unless it is used or stored outside the state 50 percent or more of the time during the six-month period immediately following the first entry into California.

Under the law, the California sales tax generally does not apply to a transaction when a California retailer sells an item and ships it directly to the purchaser at an out-of-state location for use outside California. The sale is regarded under the law as a sale in interstate commerce. In general, the sale is not taxable if the retailer:

- Ships the product directly to the purchaser, in another state or in a foreign country, using the retailer’s own delivery vehicle or another means of transport that the retailer owns; or
- Ships the product to another state or to a foreign country by delivering it to a common carrier, contract carrier, customs broker, export packer, or forwarding agent.

Under current law and Board regulations, a vehicle, vessel, or aircraft purchased by a California resident is presumed to have been purchased for use in California and is subject to the California use tax. Also, a vehicle, vessel, or aircraft purchased by a nonresident is presumed to have been purchased for use in California if it enters this state within the first 90 days of ownership. These transactions are subject to the tax unless all of the following occur:

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.

- The purchaser takes title to and possession of the vehicle, vessel, or aircraft while it is out of state; and
- The purchaser makes the first functional use of it outside the state; and
- The purchaser uses it out of state for more than 90 days before the vehicle, vessel, or aircraft first enters California.

BACKGROUND

During the 2003-04 Legislative Session, a budget trailer bill, SB 1100 (Stats. 2004, Ch. 226), amended Section 6248 of the Sales and Use Tax Law to essentially change the “90-day test” to a “12-month test.” The amendments were prompted by a perceived tax loophole with respect to the law at that time. Under these provisions, there were instances in which, for example, California purchasers of yachts from California yacht retailers were arranging delivery of the yachts outside the territorial waters of California, leaving them in Mexico for the 90-day period, and bringing them into California and escaping the California sales or use tax. The 12-month provisions incorporated into Section 6248 were intended to reduce the frequency of these sorts of arrangements.

SB 1100 addressed this issue by providing that, for the period October 2, 2004, through and including June 30, 2006, it would be rebuttably presumed that a vehicle, vessel, or aircraft bought outside this state and brought into this state during the first 12 months of the date of purchase, was acquired for storage, use, or other consumption in this state and would be subject to use tax if any of the following occurred:

- (a) The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the Vehicle Code.
- (b) In the case of a vehicle, the vehicle was subject to registration under Chapter 1 (commencing with Section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership.
- (c) In the case of a vessel or aircraft, the vessel or aircraft was subject to property tax in this state during the first 12 months of ownership.
- (d) The vehicle, vessel, or aircraft was used or stored in this state more than one-half of the time during the first 12 months of ownership.

This statute further provided that this presumption could be controverted by documentary evidence that the vehicle, vessel, or aircraft was purchased for use outside of this state during the first 12 months of ownership. In addition, the law specified that these provisions would not apply to any vehicle, vessel, or aircraft used in interstate or foreign commerce pursuant to regulations prescribed by the Board.

And, finally, Section 6248 specified that an aircraft or vessel would not be deemed to be purchased for use in this state if that aircraft or vessel was brought into this state for the purpose of repair, retrofit, or modification of the aircraft or vessel, provided that no more than 25 hours of airtime or sailing time were logged for that purpose, as specified.

This provision was extended for an additional year with another budget trailer bill (AB 1809, Ch. 49, Stats. 2006). This provision sunsetted on July 1, 2007, and the former “90-day test” provisions were reinstated beginning on that date.

PROPOSED LAW

This bill would, among other things, add Section 6248.5 to provide that the 12-month rebuttable presumption previously contained in Section 6248 shall apply to purchases of vessels.

In addition, the bill would clarify that a California resident shall also include closely held corporations and limited liability corporations (LLC's) if 50 percent or more of the shares or membership interests are held by shareholders or members who are residents of California.

Also, the bill would clarify that that repairs, retrofit, and modification will only qualify for the exception to the 12-month test if they are performed by a repair facility that holds an appropriate permit issued by the Board and is licensed to do business by the county in which it is located.

These provisions would apply to any purchase of a vessel occurring on or after July 1, 2008.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author and has been introduced to reinstate the 12-month rebuttable presumption previously applicable to vessels to minimize the revenue losses associated with the 90-day rebuttable presumption provisions in current law and close the perceived tax loophole.
- 2. The Legislative Analyst's Office reported a decline in exemptions for purchases of yachts when the 12-month test was in law.** When the law contained the "12-month test," it became more difficult for California residents to demonstrate that a vehicle, vessel, or aircraft was purchased for use outside of California and to successfully avoid both California taxes and other states' taxes. Consideration of residency and registration as factors in determining the applicability of the use tax to out-of-state purchases (rather than simply a test of time and location) closed what many perceived to be a loophole. According to an April 2006 report by the Legislative Analyst's Office, the change to the 12-month test resulted in a sharp decline in exemptions for purchases of yachts (as well as recreational vehicles) for use out of state and an increase in sales and use tax revenues.
- 3. The proposed revised definition for "California resident" would close another loophole.** For vessel purchases, when the "12-month test" became law, the Board observed that many California residents were establishing LLC's or corporations in Oregon to show an Oregon address for their vessels. The Board's Consumer Use Tax Section has identified a recurring Oregon address for the agent of record claiming exemption for transfers of vessels to a commencing corporation. The Oregon Secretary of State's database shows 973 transfers registered in Oregon by this agent as of 10/08/07. Of those, 244 have been identified as LLC's connected to California through the address identified as the principal place of business, the mailing address, or the address for the members. The bill would address this issue by specifying that a "California resident" shall also include LLC's and closely held corporations if 50 percent or more of the shares or membership interests are held by shareholders or members who are California residents.

4. Requiring that repairs and modifications must be performed by legitimate repair facilities also addresses a loophole. When the “12-month test” was in effect, an exception was made that if a vehicle, vessel or aircraft was brought into California during that test period, the exemption would not be denied if the item was brought into California for the sole purpose of repair, modification or retrofit. This exception was included in law so that California businesses that service vessels and aircraft would not be economically harmed. However, this exception was widely abused by vessel owners. Many vessel owners were constantly changing or repairing items on their vessels, and many vessels in California were used regularly without leaving their moorage. The Board has had many cases where a taxpayer regularly purchased minor parts or accessories for self-performed repairs or modifications over an extended period of time without ever sailing the vessel, and while keeping and using the vessel in California for purposes other than sailing. In one case, a taxpayer even lived on board the vessel while self-performing the repairs and modifications; but asserted that since the vessel was not sailed for more than 25 hours, the vessel was not taxable under the law.

This bill would address this issue by clarifying that repairs, retrofit, and modification would only qualify for the exception to the 12-month test if they are performed by a properly licensed repair facility. The proposed change would preserve the legislative desire to minimize the impact of the 12-month test on California businesses in the industry, while clarifying that the exception was not provided as a method of tax avoidance.

5. Board has voted to sponsor similar provisions for vessels as well as aircraft and vehicle purchases. At its November 2007 Legislative Committee meeting, the Board adopted a proposal to incorporate similar provisions in law with respect to vessels as well as vehicles and aircraft.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers and answering inquiries. However, these costs would be offset by the fewer exemptions claimed by vessel owners.

REVENUE ESTIMATE

We estimate that this bill would result in an annual increase in state and local sales and use tax revenue of \$6.8 million.

	<u>Revenue Effect</u>
State General Fund Gain (4.75%)	\$4.3 million
Fiscal Recovery Fund Gain (.25%)	.2 million
Local Gain (2.25%)	1.7 million
Special District Gain (.75%)	<u>.6 million</u>
Total	<u>\$6.8 million</u>

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