STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Chapter 545**	Bill No:	**AB 1547**
Tax:	**Sales and Use** **Special Taxes and Fees**	Author:	**Committee on Revenue and Taxation**
Related Bills:		Position:	**Support as Sponsor**

BILL SUMMARY

This bill contains **Board of Equalization (Board) sponsored provisions** for the sales and use tax and special taxes and fees programs, which would do the following under the Revenue and Taxation Code:

- Amend Section 6069 of the Sales and Use Tax Law to increase the reinstatement fee on **revoked seller's permits** from $50 to $100.
- Amend Section 6248 of the Sales and Use Tax Law to clarify the definition of "California resident" and the exception for repair, retrofit, and modification for purposes of the 12-month test for out-of-state purchases of a **vehicles, vessels and aircraft.**
- Amend Sections 7339 and 60003 of the Motor Vehicle Fuel and Diesel Fuel Tax Laws, respectively, and add Sections 7339.1 and 60003.1 to those laws to redefine a terminal to include a **fuel production facility**, as defined, with storage so that facilities outside the bulk transfer system have the same reporting requirements as terminals supplied by pipeline or vessel.
- Adds Section 55041.1 to require annual feepayers under programs administered pursuant to the **Fee Collection Procedures Law** to file a closing return when they close or sell their business.
- Amend Sections 60501 and 60508 of, and repeal Sections 60508.1, 60508.2, 60508.4, and 60509 of, the **Diesel Fuel Tax Law** to allow a supplier of diesel fuel to file a claim for refund or claim a credit on their supplier return on behalf of retailers for qualified sales to **consulate officers or consulate employees**, or to the United States and its agencies and instrumentalities.

ANALYSIS

REINSTATEMENT FEE

Revenue and Taxation Code Section 6069

Current Law

Under existing Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax is required to apply to the Board for a seller's permit. There is no fee charged for a seller's permit. Whenever a person that has obtained a seller's permit fails to comply with any of the provisions of the law under which that permit is held, existing law authorizes the Board, upon hearing for which 10 days notice has been given, to revoke the permit.

Cause for revocation may be due to a taxpayer's failure to file returns and pay the tax, failure to pay a delinquent balance, failure to post the required security, failure to keep or make available proper records, or for violation of any provision of the Sales and Use Tax Law. Under the law, a seller whose permit has been revoked for failure to comply with the law is required to pay a fee of fifty dollars ($50) to reinstate the permit.

Proposed Law

This provision would increase the reinstatement fee for revoked permits from $50 to $100.

Comment

Purpose. This provision is intended to both encourage taxpayer compliance with regard to the timely filing of returns and payment of sales and use tax liabilities as well as to defray the Board's costs associated with revoking and reinstating seller's permits. This reinstatement fee was first added to the law in 1941 and was set at $1. The fee was increased in 1966 to $15, and the Board sponsored legislation in 1986 to increase the fee to $50. Due to the rate of inflation since 1986, the equivalent reinstatement fee would be about $95 today. Therefore the proposed $100 change would be consistent with the rate of inflation since the last increase.

VEHICLES, VESSELS AND AIRCRAFT

Revenue and Taxation Code Section 6248

Current Law

The approval of the 2008-2009 California Budget included the enactment of AB 1452 (Stats 2008, Chapter 763, effective September 30, 2008), which in part amended Revenue and Taxation Code Section 6248 of the Sales and Use Tax Law. The amendments permanently replaced the "90-day test" with a "12-month test" for determining whether an out-of-state purchase of a vehicle, vessel, or aircraft was for the purpose of storage, use, or other consumption in California and subject to California use tax. This "12-month test" was also operative during the period from October 2, 2004, through June 30, 2007.

This 12-month test essentially provides that within 12 months from the date of purchase, a vehicle, vessel or aircraft purchased outside this state and then brought into California is presumed to be acquired for storage, use, or other consumption in California and subject to tax if any of the following occurred:

1. The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the California Vehicle Code, or
2. In the case of a vehicle, the vehicle was subject to vehicle registration in California during the first twelve months of ownership, or
3. In the case of an aircraft or vessel, the aircraft or vessel was subject to property tax in California during the first twelve months of ownership, or
4. If purchased by an out-of-state resident, the vehicle, vessel, or aircraft is used or stored in this state more than one-half of the time during the first 12 months of

ownership.

Under these provisions, however, the law provides that an aircraft or vessel will not be deemed to have been purchased for use in this state if that aircraft or vessel was brought into this state during the first 12 months of ownership 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. Additionally, the law provides that a vehicle brought into this state within the first 12 months of ownership for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less, as specified, would also not be deemed to be purchased for use in this state.

Proposed Law

These changes to Section 6248 would close two loopholes that surfaced when the Board administered the 12-month test provisions in 2004 through 2007, and that Board staff anticipates will resurface now that the 12-month test provisions have been made permanent.

Limited Liability Companies. With respect to the first loophole, under the 12-month test language, out-of-state residents are required to show only that the vehicle, vessel or aircraft was outside California more than six months during the first 12 months of ownership. This encouraged many California purchasers to set up shell corporations and limited liability companies in other states so that they would not be considered California residents, and would only be subjected to the six-month test, rather than the 12 month test that is applied to California residents. Therefore, this proposal would clarify that a California resident shall include closely held corporations and limited liability companies when 50% or more of their membership interests is held by shareholders or members who are California residents.

These new schemes for avoiding tax on purchases of recreational vehicles were highlighted in an article in a September 25, 2006, issue of the Los Angeles Times, “Under A Big Sky, They Turn RVs Into Dodges.” This article reported, “Montana has no sales tax, and recreational-vehicle aficionados are taking a break from their road maps and AAA Trip-Tiks to set up shell corporations in the state…Most states make it difficult for nonresidents to get license plates. But Montana lets out-of-staters register vehicles if they own a local limited liability corporation. Setting one up merely requires some simple paperwork and about $1300 to cover incorporation costs, registration fees and attorney hours.”

By setting up a limited liability company in Montana to own an RV, California residents could not only take advantage of Montana’s lower vehicle registration fees, but when they brought their RV’s into California, they believed that their purchases were not subject to the same presumptions regarding whether or not the vehicles were purchased for use in California as vehicle purchases by other California residents.

The staff received information that showed that approximately 900 vehicles were registered in Montana by Montana limited liability companies that appear to be closely held by California residents. Estimated taxable measure for these 900 vehicles is $227 million with tax of $16.5 million. The Los Angeles Times article, Under a Big Sky…, reported that based on comparisons of Montana vehicle records with California addresses, officials at the California Attorney General’s office indicated that they believe as many as 10,000 Californians have put Montana plates on their motor homes in recent years, costing the State over $160 million for “this particular type of fraud.”

For vessel purchases, it appears that many California residents are establishing limited liability companies 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. As of October, 2008, the Oregon Secretary of State’s database indicated that 2,103 transfers were registered in Oregon by this agent. Of those, 1,478 have been identified as limited liability companies connected to California through the address identified as the principal place of business, the mailing address, or the address for the members.

Repairs. With regard to the second loophole, the law makes an exception for repair, retrofit, and modification so that if a California resident brings a vehicle, vessel or aircraft into California during the 12-month test period solely for those services, the 12-month out-of-state usage requirement to avoid the tax wouldn't be violated. This proposal would clarify that repair, retrofit and modification must be performed by a licensed repair facility in order to qualify for the exception.

The repair, retrofit and modification exception was included in law so that California businesses that service vehicles, vessels and aircraft would not be harmed economically. The abuses of this exception with aircraft were minor since the FAA requires that aircraft maintenance and modification be performed or inspected by an FAA certified repair facility. 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. Board staff has had many cases in which a taxpayer regularly purchased minor parts or accessories for self-performed repair or modification 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 repairs and modification, but asserted that since the vessel was not sailed for more than 25 hours, the vessel was not taxable under the law.

Comment

Purpose. These proposed changes are intended to 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.

FUEL PRODUCTION FACILITIES

Revenue and Taxation Code Sections 7339, 7339.1, 60003, 60003.1

Current Law

Under existing Section 7339 of the Motor Vehicle Fuel Tax Law (Part 2 (commencing with Section 7301) of Division 2 of the Revenue and Taxation Code) (gasoline) and Section 60003 of the Diesel Fuel Tax Law (Part 31 (commencing with Section 60001) of Division 2 of the Revenue and Taxation Code) (diesel), a terminal is defined as a distribution facility that is supplied by pipeline or vessel, and from which the gasoline or diesel fuel may be removed at a rack.

Section 7333 and Section 60006 define a rack as a mechanism for delivering fuel from a refinery or terminal into a truck, trailer, railroad car, or other means of non-bulk transfer. Bulk transfer means any transfer of fuel by pipeline or vessel.

Both the gasoline and diesel fuel tax laws define a terminal operator as a supplier of the respective fuel (Sections 7338 and 60033). As a supplier, the terminal operator is required to be licensed with the Board (Sections 7451 and 60131) and is required to file a monthly information report detailing, among other things, the amount of fuel received, removed, and stored at each terminal it operates (Sections 7652.5 and 60204).

In general, both the gasoline and diesel fuel tax is imposed upon the removal of the fuel in this state from a terminal, if the fuel is removed at the rack. A supplier is generally responsible for the tax.

Under existing law, for a facility to be licensed as a terminal, it must be able to receive fuel by pipeline or vessel and be able to remove fuel over a rack.

However, over the past few years, Board staff has noted an emerging trend in the fuel industry where fuel products are produced and enter the market from outside the traditional bulk transfer system. This trend coincides with the push towards alternative and renewable fuel products, such as biodiesel. These production sites typically have storage facilities that store the fuels produced and have loading racks to ship the fuel products to customers. However, because they are not supplied by a pipeline or vessel, these production facilities are not currently licensed as terminals and, therefore, do not file terminal reports on their fuel storage and removal activities.

Because existing laws did not envision that there would be large scale production of fuel products outside the bulk transfer system, there is a deficiency in the Board's ability to account for this fuel as it enters the marketplace. Without terminal reporting of this fuel, Board staff cannot match all the fuel transactions reported by licensed suppliers and, therefore, cannot verify that all taxable fuel entering the market in California and the tax on that fuel is properly reported and remitted.

Background

In 1995 and in 2002, the imposition of the diesel fuel and gasoline taxes, respectively, was moved to the rack. At that time, virtually all fuel sold in the state was produced from petroleum stocks at refineries and moved into the marketplace through the pipeline and terminal network throughout the state. The fuel taxes laws and the tax/transaction reporting system was developed around the traditional bulk transfer (refinery-pipeline-terminal) model of fuel movements. California's fuel tax/transaction reporting system includes monthly tax returns filed by licensed fuel suppliers, and monthly reports submitted by terminal operators and bulk (pipeline, vessel) carriers. Non-bulk carriers, specifically train operators, are required to file monthly information reports beginning in 2009 (AB 3079, Stats. 2008, Ch. 306). All parties report load-by-load transaction details. The Board then compares the terminal and carrier report data to the data provided on supplier tax returns to verify that all taxable fuel products removed from the terminals in this state are properly reported and the appropriate tax remitted.

Proposed Law

These changes would amend the gasoline and diesel fuel tax laws to include in the definition of a terminal, a gasoline or diesel fuel production facility with storage that is not supplied by pipeline or vessel and from which the fuel produced may be removed at a rack. These changes would also add a definition of "fuel production facility" to the gasoline and diesel fuel tax laws. These proposed changes would place the same licensing and reporting requirements on fuel production facilities supplied outside the bulk transfer system as are imposed on those facilities currently supplied by pipeline or vessel.

Besides biodiesel production facilities, these changes would also cover other stand-alone fuel production facilities, such as transmix refractionation plants. Transmix is a fuel mixture of dissimilar fuels (usually gasoline and diesel fuels) that results when one fuel type is run through a pipeline after another type of fuel is run through the same pipeline. Transmix is captured at terminals and either returned to refineries to be re-refined or sent to transmix plants where the mixture is broken down (refractionated) into its component gasoline and diesel fuel parts. Based on analysis of supplier reporting and discussions with the California Air Resources Board, it is estimated that in-state production of biodiesel during 2007 totaled 6 million gallons. Transmix movements from terminals during the same period totaled 194 million gallons.

Comment

Purpose. These amendments are intended to enable Board staff to match the fuel transactions reported by licensed suppliers to verify that all taxable fuel entering the market in California is properly reported and taxed.

TIRE FEE FINAL RETURN

Revenue and Taxation Code Sections 55041.1

Current Law

There is no provision under current law that requires feepayers who file annual returns under the California Tire Fee program (Chapter 17 (commencing with Section 42860) of Part 3 or Divisions 30 of the Public Resources Code) to file closing returns and pay the fees that are due to the Board at the time that they cease to engage in business in this state by reason of discontinuance, sale, or transfer their businesses.

Such feepayers, especially those that close out their business operations in the second or third quarter of the calendar year, may not timely file their returns and pay the fees due by the annual statutory due date because they are no longer engaged in business. For example, if a feepayer closed its business operations on May 16, 2008, it would not be required to file an annual return and pay the fees due to the Board until the annual statutory due date of January 15, 2009.

Failure of these feepayers to timely file their annual returns often results in a delinquency and becomes a collection action that involves expenditure of additional Board resources to recover the unreported fees and additional interest and penalty.

Proposed Law

The California Tire Fee is administered by the Board pursuant to the Fee Collection Procedures (FCP) Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). This change would establish a requirement in the FCP Law that every person who is required to file an annual return under the law file a closing return and pay any fees due to the Board upon the discontinuance, sale, or transfer of his or her business during the calendar year. This proposed language is similar to existing language in other tax and fee programs administered by the Board.

Under this provision, a feepayer that reports and pays the tire fee on an annual basis would be required to file a closing return and pay any fees that are due to the Board at the time it ceases to engage in business during the calendar year.

Comment

Purpose. This change is intended to require feepayer to close out its tire fee account at the same time it closes its sales and use tax permit with the Board, which would make it more convenient for the feepayer, more reliable for any successor, and more efficient for the Board. As a result, the Board would be able to collect and deposit fees due earlier during the calendar year, rather than after the year has ended, and reduce expenses for recovering and collecting delinquent fees from feepayers that fail to timely file their annual returns.

This provision would also allow the Board to work with feepayers in other programs administered under the FCP Law to change their reporting basis, as needed, to provide more efficient and improved customer service.

CLAIM FOR REFUND/CREDIT US GOVERNMENT/CONSULATE OFFICERS AND EMPLOYEES

Revenue and Taxation Code Sections 60501,
60508, 60508.1, 60508.2, 60508.4, and 60509

Current Law

In general, under the existing Diesel Fuel Tax Law (Part 31, Division 2 of the Revenue and Taxation Code, commencing with Section 60001), the state provides an excise tax exemption for diesel fuel that is (1) dyed, (2) exported out of state, (3) sold to the United States government and its agencies or instrumentalities, (4) sold to certain consulate officers and consulate employees, (5) used off-highway and (6) used for agricultural purposes.

Section 60501 allows a diesel fuel supplier to claim a refund of the tax on diesel fuel when the tax-paid diesel fuel is exported, removed, sold, or used by a supplier under certain conditions. Some of the conditions include, but are not limited to, sale of diesel fuel under specified circumstances by a supplier to any consulate officer or consulate employee, and sales to the United States and its agencies and instrumentalities.

Section 60508.1 allows a diesel fuel supplier to take a credit in lieu of refund on the supplier's tax return for sales of tax-paid diesel fuel to a consulate officer or consulate employee.

The current Motor Vehicle Fuel Tax Law provides that motor vehicle fuel (gasoline) suppliers are able to claim a refund, or take a credit in lieu of refund, for qualified tax-paid sales to the armed forces of the United States or to a consulate officer or consulate employee. The gasoline tax statutes were drafted to allow suppliers who did not sell directly to the consulate officer or consulate employee the ability to file a claim for refund on behalf of the retailer.

<u>Sales of tax-paid diesel fuel to consulate officer or consulate employee</u>. Current Section 60501(a)(4)(F) provides that a claim for refund is allowed for diesel fuel sold by

a supplier to any consulate officer or consulate employee under circumstances which would have entitled the supplier to an exemption under paragraph (6) of subdivision (a) of Section 60100 if the supplier had sold the diesel fuel directly to the consulate officer or consulate employee. Generally, Section 60508.1 provides that the supplier may take a credit in lieu of a refund on the supplier's tax return. Under existing diesel fuel statutes, only a supplier who sells directly to a consulate officer or employee is entitled to claim the credit for the tax or file a claim for refund. No provision exists that allows a retailer to claim a refund for the sales it makes under these circumstances; therefore, the supplier is unable to claim a refund, or take a credit, when the sale is made by the retailer.

Sales of tax-paid diesel fuel to the United States and its agencies and instrumentalities. Under existing Section 60501(a)(4)(H), a claim for refund is allowed for diesel fuel sold by a person (not just a supplier) to the United States and its agencies and instrumentalities under circumstances that would have entitled that person to an exemption from the payment of diesel fuel tax under Section 60100 had that person been the supplier of the diesel fuel. Under existing diesel fuel statutes, only the person who sells to the United States and its instrumentalities is entitled to claim the credit for the tax or file a claim for refund. No provision exists that allows a supplier to claim a refund, or take the in lieu credit, when the retailer made the direct sale to the United States and its instrumentalities.

Proposed Law

These changes would amend Sections 60501 and 60508, and repeal Sections 60508.1, 60508.2, 60508.4, and 60509 of the Diesel Fuel Tax Law to allow suppliers to file claims for refund, or take a credit in lieu of a refund, on their supplier returns on behalf of retailers for diesel fuel taxes on qualified retail sales to consulate officers or consulate employees or to the United States and its agencies and instrumentalities and to more closely conform the provisions of the Diesel Fuel Tax Law with the provisions of the gasoline tax law.

These changes would allow the oil company, i.e., the supplier, to claim the credit on its supplier return and avoid the necessity of obtaining reimbursement for the tax from the franchisee and the necessity for the franchisee to file a claim for refund with the Board. This approach is supported by the industry and will reduce the number of claims for refund and potential controversies over claims that are submitted by the wrong person or that may be barred by the statute of limitations.

Background

The current diesel fuel refund statutes worked well when major oil companies owned and operated most service stations and the oil companies, who were licensed suppliers, could take credit for the tax included in the retail sale on their supplier return. However, the industry has evolved, and now most "branded" stations are franchised or leased to independent retailers.

In practice, oil companies have continued to use the accounting methods that were put into place prior to the franchising of the company-operated stations and have claimed credit for these taxes on their returns. However, in an audit situation, if the supplier had erroneously claimed credits for its franchisee's sales to a consulate officer or the U.S. Government, the audit staff disallows the credits. This results in the supplier having to obtain reimbursement for the taxes from the franchisee. The franchisee then, at least with respect to sales to the U.S. Government, needs to file a claim for refund for those periods and amounts that are still within the statute of limitations.

Comment

Purpose. These amendments are intended to simply allow diesel fuel suppliers to file claims for refund, or take a credit in lieu of a refund, on their supplier returns on behalf of retailers for diesel fuel taxes on qualified retail sales to consulate officers or consulate employees or to the United States and its agencies and instrumentalities, consistent with the gasoline tax.

COST ESTIMATE

Enactment of the provisions of this measure would not materially impact the Board's administrative costs.

REVENUE ESTIMATE

Seller's Permit Reinstatement Fee. The increase in the seller's permit reinstatement fee would result in an estimated annual state General Fund increase of $400,000 annually.

Vehicles, Vessels, and Aircraft. With respect to the vehicle, vessel and aircraft rebuttable presumption, it is difficult to determine whether enactment of this bill would actually increase state and local revenues. Many purchasers may simply choose to keep their vehicle, vessel or aircraft outside the state during the first 12 months of ownership in order to avoid payment of the use tax.

Total LLCs purchasing vehicles, vessels and aircraft identified as LLCs connected to California through the address identified as the principal place of business, the mailing address, or the address for the members were 318, comprised of the following:

	Number	Average Use Tax	Total Tax (in millions)
Vessels	163	$ 8,740	$1.4
Aircraft	14	7,004	1.0
Vehicles (RVs)	141	17,760	2.5
Total	318		$ 4.9

If we were to assume that after enactment of this bill, 10% of the California purchasers that had formed LLCs outside this state would bring their vehicle, vessel, or aircraft into California within the first 12 months of ownership, we would see an annual increase in California use tax of approximately $490,000 ($ 4.9 million x 10%).

Remaining Provisions. The provisions relating to fuel production facilities, biofuels, and tire fee taxpayers' final return could result in a potential gain in revenues of an indeterminable amount.

REVENUE SUMMARY

Enactment of this measure would increase revenues as follows:

Seller's Permit Reinstatement Fee:	$400,000 (General Fund)
Use Tax on Vehicles, Vessels, & Aircraft	$490,000 (state and local combined)

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