



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	06/30/03	Bill No:	SB 760
Tax:	Sales and Use	Author:	Scott and Alpert
Board Position:		Related Bills:	

BILL SUMMARY

This bill would extend the sunset date of January 1, 2004 until January 1, 2009 for the existing sales and use tax exemption for the sale and leaseback of public passenger transportation vehicles when sold or leased by a transit authority, special district, or governmental entity. This bill would also provide, in the event that the current exemption is repealed, a sales and use tax exemption for the sale of a public passenger transportation vehicle to a qualified person at the end of a lease, provided the purchaser qualified for the exemption at the time the lease was entered into.

Summary of Amendments

Since the previous analysis, amendments to this bill provide that the provisions in this bill would become operative on January 1, 2004.

ANALYSIS

Current Law

Under the existing sales and use tax law, sales or use tax applies to the sale or use of all tangible personal property, unless specifically exempted. Generally, a sale includes any lease of tangible personal property for a consideration. However, leases of mobile transportation equipment are specifically excluded from the definition of a "sale." Mobile transportation equipment (MTE) includes equipment such as railroad cars, buses, trucks, tractors, aircraft and ships. The lessor of MTE is regarded as the consumer of the property and tax applies to the retail sale to the lessor, unless the lessor makes a timely election to report tax on the fair rental value.

Current law also provides for a sales and use tax exemption for the sale and leaseback of public passenger transportation vehicles. Section 6368.8 of the Sales and Use Tax Law provides an exemption from the sales and use tax for the sale in this state of, or the storage, use, or other consumption in this state of qualified equipment sold or leased by a qualified person and leased or subleased back to that qualified person. To qualify for the exemption, the qualified equipment must be sold or leased by a qualified person, the qualified person must have paid sales tax reimbursement or use tax with respect to the acquisition of the qualified equipment, and the qualified equipment must be sold or leased back to the qualified person. This section also provides that the exemption applies to subsequent purchases of qualified equipment by a qualified person at the end of the term of a lease or sublease of qualified equipment. Section 6368.8 contains a sunset date of January 1, 2004.

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Proposed Law

This bill would extend the January 1, 2004 sunset provision until January 1, 2009 in Section 6368.8 of the Revenue and Taxation Code to provide a sales and use tax exemption for the sale and leaseback of public passenger transportation vehicles when sold or leased by a transit authority, special district, or governmental entity to continue indefinitely.

This bill would also require the Legislative Analyst, in consultation with the Board of Equalization and the Franchise Tax Board, to conduct a study on the impact of the exemption in this bill and to report the findings to the Legislature by January 1, 2008. Specifically, this study would include the following:

- The number of persons utilizing the exemption.
- The fiscal impact of the exemption, including the total exemption amount and any depreciation claimed for qualified equipment.
- The impact, if any, of federal law on the utilization of the exemption.
- The impact of the exemption on California's public transit sector.
- A recommendation as to whether the exemption should be continued and any recommendations on modifications to the existing exemption provisions.
- The impact, if any, on the California personal income and corporation taxes, based on information provided by persons utilizing the exemption.

This bill would also require a qualified person, within five business days after the execution of a transaction exempted under the provisions of this bill, to provide the following information to the Franchise Tax Board, the Legislative Analyst, the Department of Transportation, the Senate Revenue and Taxation Committee, and the Assembly Revenue and Taxation Committee:

- Copies of the consent letter obtained by the qualified person from the Federal Transit Administration (FTA) within the United States Department of Transportation, authorizing the transaction under FTA circular 7020.1.
- Copies of the appropriate Internal Revenue Service Form 8264.
- A report describing how the qualified person is using the benefits derived from the sale and leaseback transaction.

This bill would also require the Franchise Tax Board to review the information provided above by qualified persons every other year, and to assess the revenue loss to the state, if there is any. The Franchise Tax Board would be required to report this information to the Legislative Analyst, the Senate Revenue and Taxation Committee and the Assembly Revenue and Taxation Committee.

This bill would also add Section 6368.9 to provide that if Section 6368.8 is repealed, a sales and use tax exemption would apply to the subsequent purchases of qualified equipment by a qualified person at the end of the term of a lease or sublease of qualified equipment, provided the following conditions were met:

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- As of the date the lease or sublease was entered into, the qualified person and qualified equipment were otherwise eligible for the exemption provided by Section 6368.8.
- The lease or sublease was entered into before the repeal date of Section 6368.8.

The provisions in this bill would become effective immediately, but would become operative on January 1, 2004.

Background

Since 1990, a number of California transit agencies have sought to generate additional revenues by entering into transactions which transfer the depreciation attributes of an asset, such as passenger rail cars or buses, to a private taxable entity. Such arrangements are described as a "sale and leaseback." The transaction allows the private firm to take federal income tax deductions, while permitting the equipment to be used by the transit agency for its intended public purpose of providing transit services. In exchange for participating in the transaction, the transit agency receives an up-front payment from the private firm. The up-front payment from the private firm is enough to cover the lease payments over the term of the lease, plus a premium of 6-8 percent of the equipment cost. This 6-8 percent premium is revenue the transit agency can use to meet future transit capital or operating needs.

The transit agency pays sales or use tax on the initial purchase of the equipment. However, if a transit agency were to enter into a sale and leaseback under the law prior to November 1, 2001, the sale by the transit agency to the purchaser/lessor would also be subject to sales or use tax. This additional sales or use tax expense would offset the 6-8 percent premium that the transit agency would have received. Due to the imposition of the sales and use tax, there was no financial benefit for either party to enter into such a transaction.

Assembly Bill 984 (Ch. 592, Stats. 2001) provides an exemption from the sales and use tax for the sale in this state of, or the storage, use, or other consumption in this state of qualified equipment sold or leased by a qualified person and leased or subleased back to that qualified person. This exemption also applies to subsequent purchases of qualified equipment by a qualified person at the end of the term of a lease or sublease of qualified equipment. To verify that the new exemption was working as intended, AB 984 included a sunset date of January 1, 2004 and also required that the Legislative Analyst Office (LAO) prepare a report to the Legislature on the fiscal impact of this exemption and recommendations as to whether the exemption should be extended.

The LAO released their report in January of this year. The findings in the report indicate that the current sales and use tax exemption provided by AB 984 is an effective means of increasing the amount of resources available to public transit districts with limited state revenue losses. The LAO report provides the following recommendation:

"The sales and use tax (exemption) granted through Chapter 592 is scheduled to sunset on January 1, 2004. Based on our examination of the impact of this exemption on the state and local governments, we believe that a strong case can be made for removing the sunset date and allowing the (exemption) to continue. The (exemption) results in a significant amount of new revenues to transit

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districts each year at a relatively low cost to the state (roughly a 10-to-1 ratio). Even with a high local benefit-to-state cost ratio, however, the (exemption) should be continued only if the Legislature believes that transit districts are spending these funds on projects or activities of value."

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored jointly by the Metropolitan Transportation Authority and the California Transit Association. The purpose of this bill is to extend the current sales and use tax exemption that allows public transit districts to enter into financially beneficial sale-leaseback agreements without penalty of paying the sales and use tax twice.
- 2. Key amendments.** **June 30** amendments provide that the provisions in this bill would become operative on January 1, 2004. **June 26** amendments provide that the provisions in this bill would become operative on the first day of the first calendar quarter commencing more than 90 days after the effective date, but not later than January 1, 2004. **April 30** amendments to this bill extend the existing sunset date of January 1, 2004 until January 1, 2009 rather than eliminate the sunset date. Additional amendments require qualified persons to provide specified information related to the transactions exempted by this bill, the Franchise Tax Board to assess revenue losses related to the provisions in this bill every other year, and would require the Legislative Analyst Office, in consultation with the Board of Equalization and the Franchise Tax Board, to conduct a study on the impact of the exemption in this bill and to report the findings to the Legislature by January 1, 2008. **April 8** amendments added Section 6368.9 which provide that if Section 6368.8 is repealed, a sales and use tax exemption would apply to the subsequent purchases of qualified equipment by a qualified person at the end of the term of a lease or sublease of qualified equipment. Current law (Section 6368.8) would provide an exemption for the subsequent purchase of qualified equipment by a qualified person at the end of the term of a lease, but that provision is scheduled to sunset as of January 1, 2004. This amendment would protect the qualified person that has already entered into a long term sale/leaseback transaction from an unexpected sales and use tax burden at the end of the lease term in the event that attempts to extend the sunset date in current law are unsuccessful.
- 3. Report to the Legislature would be required.** The provisions of this bill would require the Legislative Analyst, in consultation with the Board of Equalization and the Franchise Tax Board, to report to the Legislature by January 1, 2008 on the impact of the exemption in this bill. Based on the items required to be addressed in the report to the Legislature, it appears the Board would be responsible for determining the number of persons utilizing the exemption afforded in this bill.
- 4. Suggested technical amendments.** Section 6368.8 currently defines the terms "qualified equipment" and "qualified person." This bill would add Section 6368.9, which makes reference to these definitions in Section 6368.8. However, Section 6368.9 would only become operative if Section 6368.8 were repealed. If Section 6368.8 were to be repealed, it would no longer appear in the law guide, so the

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reference in Section 6368.9 to the definitions in Section 6368.8 would be of little use. It is recommended that Section 6368.9 be amended to include the definitions within that section rather than making a reference to Section 6368.8.

On page 4, line 29, this bill provides, "The board shall report its assessment to the Legislative Analyst..." As written, "board" would refer to the Board of Equalization. However, based on the sentence beginning on line 24, it appears the reporting should be done by the Franchise Tax Board rather than the Board of Equalization. It is recommended that "board" on line 29 be amended to read "Franchise Tax Board."

- 5. The provisions of this bill would not be problematic to administer.** Since the Board is already administering the current exemption, extending the sunset date and allowing the exemption to continue would not be problematic for the Board.

COST ESTIMATE

As the Board is currently administering this exemption, any costs associated with extending the sunset date and assisting in preparing a report to the Legislature would be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill would extend the sunset provision in current law until January 1, 2009 and would continue to exempt from the sales and use tax the sale/leaseback or lease/leaseback transactions that transit agencies might enter into. Under these types of arrangements, the transit district either sells or leases vehicles, for which the sales or use tax has already been paid on the original acquisition, to a private entity. The private entity then leases the vehicles back to the transit authority. The transaction, in effect, transfers the tax depreciation attributes of the vehicles to the private entity. The transit authority uses the vehicles for public transit services and receives an up-front payment from the private entity. Without the exemption provided by current law, it would not be cost effective for transit agencies to enter into such sale/leaseback arrangements.

The exemption provided by current law also applies to the final sale of the public transit vehicle back to the transit agency at the end of the sale/leaseback term. This bill would also add an exemption for the sale of the public transit vehicle back to the transit agency at the end of the sale/leaseback transaction if the current exemption were to sunset.

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Revenue Summary

There would not be a material sales and use tax revenue impact from continuing to provide an exemption from the sales and use tax for the sale/leaseback or lease/leaseback agreements concerning public passenger transportation vehicles. If the exemption were to sunset, these types of transactions would no longer be cost effective and no additional agreements would be entered into without this exemption.

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