

INITIAL DISCUSSION PAPER

Proposed Regulation for Partial Exemption for the Sales and Use of Racehorse Breeding Stock

Issue

Should the Board adopt a proposed regulation for implementing the provisions of Assembly Bill 426 regarding a partial exemption allowed to qualified persons for purchases of racehorse breeding stock?

Background

The California State Legislature has previously considered bills that provide an exemption from sales and use taxes for thoroughbred horses. AB 2679 (Wright) of the 1986-87 Legislative Session would have created an exemption from the sales and use tax imposed on the gross receipts from the sale and purchase of a thoroughbred horse or an Arabian horse which is used as breeding stock. AB 2757 (Wright) of the 1987-88 Legislative Session would have created an exemption similar to Revenue and Taxation Code section 6358.5. In addition to exempting racehorse breeding stock, AB 2757 would have exempted from the sales and use tax gross receipts attributable to stallion services, thoroughbred horses less than two years of age sold to an out-of-state resident that are transported outside California, boarding and training thoroughbred horses, and the temporary use of thoroughbred horses within this state for the purpose of racing, exhibiting, or performing.

California has long been one of the nation's top three producers of registered foals. The other two states, Kentucky and Florida, provide tax incentives for the racehorse breeding industry. Kentucky exempts all horses from sales and use tax. Florida exempts the sale of a racehorse by its owner, provided the owner is also the breeder of the animal. Prior to the enactment of this statute, sales of racehorse breeding stock in California were subject to tax at the applicable state, local and county tax rate with no specific exemptions or exclusions.

Proponents of legislation to exempt racehorse breeding stock from taxation in California contend that the exemption could ultimately increase state tax revenues as it would promote racehorse breeding in the state. The subsequent increase in the number of racehorses in California would actually increase the revenue base as horses remain subject to tax when sold for racing purposes. In addition to the increased number of horses, racehorses are generally sold at a higher price than racehorses that are sold solely for breeding purposes.

Assembly Bill 426, Stats. 2001, Chap. 156 (AB 426) authored by Assembly Member Dennis Cardoza, among other provisions, enacted Revenue and Taxation Code (RTC) section 6358.5 to provide a partial exemption for sales and purchases of racehorse breeding stock. See Exhibit 1.

This partial tax exemption applies to only the state portion of the tax. While the state portion of the tax is currently 4.75%, the tax rate (and exemption) will increase to 5% effective January 1, 2002. The local taxes and taxes imposed by special taxing jurisdictions still apply. The provisions of this statute have an operative date of September 1, 2001.

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Discussion of Proposed Regulatory Language

Staff proposes regulatory language that implements, interprets, and makes specific the provisions of RTC section 6358.8. A copy of staff's proposed regulation is attached as Exhibit 2. After a brief overview of the general provisions of the partial exemption in subdivision (a), staff proposes definitions for terms used throughout the regulation in subdivision (b).

Staff proposes subdivision (c) to provide clarification with respect to partial exemption certificates. In general, to claim any exemption from sales and use tax on a qualifying sale or purchase of tangible personal property, the purchaser is obligated to file an exemption certificate with the retailer from whom the property is being purchased. Retailers who take a certificate timely and in good faith are relieved from the liability for the sales or use tax subject to the exemption. "Timely" is defined, in this and other regulations, as taking the certificate any time before the retailer bills the purchaser for the property, any time within the retailer's normal billing or payment cycle, or any time prior to the delivery of the property to the purchaser. If the retailer fails to obtain a timely exemption certificate, relief of the tax liability is not provided unless the retailer presents satisfactory evidence to the Board that the property was sold to an applicable qualifying person and used in a qualifying manner. It is assumed that a retailer has accepted an exemption certificate in good faith in the absence of evidence to the contrary. Under this proposed regulation, the vendor must obtain a timely racehorse breeding stock partial exemption certificate in order for the vendor to consider the sale as partially exempt from sales or use tax.

A purchaser filing a partial exemption certificate is not required to use any specific form. While a purchaser may elect to use copies of the partial exemption form included in the proposed regulation, any written document containing all of the essential elements provided in subdivision (c)(3) of the proposed language will relieve the retailer of his or her obligation to collect and remit the tax.

Due to the short implementation time for the enacting statute, the proposed regulation is not expected to be adopted until several months following the operative date. Although the statute requires that a racehorse breeding stock partial exemption certificate be issued in a timely manner, staff proposes language in subdivision (e) to provide a window within which a qualified person may file a claim for refund. Claims for refund pertaining to transactions subject to sales tax must be filed with the vendor who sold the property to the qualified person.

Subdivision (g) clarifies that the purchaser is liable for the payment of tax if the transaction does not qualify for the racehorse breeding stock partial exemption. The tax is due as if the purchaser were a retailer making a retail sale of the property at the time the property has been converted to a non-qualifying use or the date the purchaser no longer qualifies for the partial exemption, whichever is applicable.

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In subdivision (h), staff proposes regulatory language to provide that leases of tangible personal property which are classified as “continuing sales” and “continuing purchases” qualify for the racehorse breeding stock partial exemption subject to all the conditions and limitations set forth in the regulation.

Summary

Staff proposes regulatory language to implement the provisions of RTC section 6358.5 and welcomes any comments, suggestions, and input from interested parties regarding this issue.

Prepared by the Program Planning Division, Sales and Use Tax Department

Current as of 11/26/2001

Revenue and Taxation Code Section 6358.5
As Amended by AB 426 (Chap. 156) Stats. of 2001

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SEC. 7. Section 6358.5 is added to the Revenue and Taxation Code, to read:

6358.5. (a) (1) There are exempted from the taxes imposed by this part, the gross receipts from the sale in this state of, and the storage, use, or other consumption in this state of, any racehorse breeding stock.

(2) For purposes of this section "racehorse breeding stock" means a horse that is capable of reproduction and for which the purchaser states that it is the purchaser's sole intent to use the horse for breeding purposes.

(b) (1) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section does not apply with respect to any tax levied by a county, city, or district pursuant to, or in accordance with, either of those laws.

(2) The exemption established by this section does not apply with respect to any tax levied pursuant to either Section 6051.2 or 6201.2, or pursuant to Section 35 of Article XIII of the California Constitution.

(c) The exemption provided by this section shall be effective starting September 1, 2001, unless the State Board of Equalization determines that implementation by that date is not feasible, in which case the board shall, on or before that date, report to the Legislature regarding the reasons why it must delay implementation, and shall thereafter implement the exemption provided by this section no later than October 1, 2001.

Proposed Regulation 1535. Racehorse Breeding Stock

Reference: Section 6358.5, Revenue and Taxation Code.

(a) GENERAL. Commencing on and after September 1, 2001, Section 6358.5 of the Revenue and Taxation Code authorizes a partial exemption from sales and use tax imposed on the gross receipts from the sale of, and the storage, use, or other consumption in this state, of racehorse breeding stock purchased by a qualified person. The terms “racehorse breeding stock” and “qualified person” are defined below.

For the period commencing on January 1, 2001 and ending December 31, 2001, the partial exemption applies to the taxes imposed by Sections 6051 and 6201 of the Revenue and Taxation Code (4.75%), but does not apply to the taxes imposed pursuant to Sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of article XIII of the California Constitution.

For the period commencing on January 1, 2002, the partial exemption applies to the taxes imposed by Sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (5%), but does not apply to the taxes imposed pursuant to Sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or Section 35 of article XIII of the California Constitution

(b) DEFINITIONS. For purposes of this regulation:

(1) “Qualified person” means a person who purchases racehorse breeding stock solely with the intent and purpose of breeding.

(2) “Qualified property” means racehorse breeding stock, as defined in subdivision (b)(3).

(3) “Racehorse breeding stock” means a live horse that meets all of the following:

(A) Is or was eligible to participate in a horseracing contest in California wherein pari-mutuel racing is permitted under rules and regulations prescribed by the California Horse Racing Board.

(B) Is capable of producing foals which will be eligible to participate in a horseracing contest in California wherein pari-mutuel racing is permitted under rules and regulations prescribed by the California Horse Racing Board.

(C) Is or was registered with an agency recognized by the California Horse Racing Board. Agencies currently recognized are The Jockey Club, The American Quarter Horse Association, The United States Trotting Association, The Appaloosa Horse Club, and The Arabian Horse Registry of America.

Racehorse breeding stock includes a registered male horse that has serviced three or more registered females for the purpose of producing a racehorse during the two previous calendar years or a registered female horse that has been bred to a registered male for the purpose of producing a racehorse during the two previous calendar years. Racehorse breeding stock does not include any horse over three years old, or four years old in the case of an Arabian horse, that has not participated in a horserace contest on which pari-mutuel wagering is permitted or has not been used for breeding purposes in order to produce racehorses during the two previous calendar years.

(4) “Solely” means 100% or “only.”

(c) PARTIAL EXEMPTION CERTIFICATES.

(1) IN GENERAL. Qualified persons who purchase or lease qualified property from an in-state retailer, or an out-of state retailer obligated to collect use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If the retailer takes a partial exemption certificate timely and in good faith from a qualified person, the partial exemption certificate relieves the retailer from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A partial exemption certificate will be considered timely if it is taken any time before the retailer bills the purchaser for the qualified property, any time within the retailer's normal billing or payment cycle, or any time at or prior to delivery of the qualified property to the purchaser. A partial exemption certificate which is not taken timely will not relieve the retailer of the liability for tax excluded by the partial exemption; however the retailer may present satisfactory evidence to the Board that the retailer sold the specific property to a qualified person and the property was used in a qualifying manner. For purposes of this regulation, it is presumed that a retailer accepts a partial exemption certificate from a purchaser in good faith in the absence of evidence to the contrary. Notwithstanding subdivision (e), a partial exemption from the sales or use tax under this part shall not be allowed unless the retailer timely files a sales and use tax return claiming the partial exemption.

The partial exemption certificate form set forth in Appendix A may be used to claim the partial exemption.

(2) BLANKET PARTIAL EXEMPTION CERTIFICATES. In lieu of requiring a partial exemption certificate for each transaction, a qualified person may issue a blanket partial exemption certificate. The blanket partial exemption certificate form set forth in Appendix A may be used as a blanket partial exemption certificate by checking the first box in Part 1. Qualified persons must include in the blanket partial exemption certificate a description of the qualified property. If purchasing tangible personal property not qualifying for the partial exemption, the qualified person must clearly state in documents such as a written purchase order, sales agreement, lease, or contract that the sale or purchase is not subject to the blanket partial exemption certificate.

(3) FORM OF PARTIAL EXEMPTION CERTIFICATE. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a partial exemption certificate with respect to the sale or purchase of the property described in the document if it contains all of the following essential elements:

- (A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.
- (B) The name, address and telephone number of the purchaser.
- (C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.
- (D) A statement that the property purchased is capable of reproduction.
- (E) A statement that the purchaser will use the property solely for the purpose of breeding.
- (F) A description of the property purchased.
- (G) Date of execution of the document.

(4) **RETENTION AND AVAILABILITY OF PARTIAL EXEMPTION CERTIFICATES.** A retailer must retain each partial exemption certificate received from a qualified person for a period of not less than four years from the date on which the retailer claims a partial exemption based on the exemption certificate.

While the Board will not normally require the filing of the partial exemption certificate with a sales and use tax return, when necessary for the efficient administration of the Sales and Use Tax Law, the Board may on 30 days' written notice, require a retailer to commence filing with its sales and use tax returns copies of all partial exemption certificates. The Board may also require that, within 45 days of the Board's request, retailers furnish to the Board any and all partial exemption certificates, or copies thereof, accepted for the purposes of supporting the partial exemption.

(d) PARTIAL EXEMPTION CERTIFICATE FOR USE TAX. The partial exemption certificate must be completed by a qualified person to claim a partial exemption from use tax on purchases of qualified property from an out-of-state retailer not obligated to collect the use tax. Notwithstanding subdivision (e), a partial exemption from the use tax shall not be allowed unless the qualified person:

(1) Timely files a sales and use tax return or consumer use tax return for the period in which the purchase occurs and timely pays any applicable tax in full that is excluded from this partial exemption as provided in subsection (a) of this regulation; and

(2) Attaches a completed partial exemption certificate to the sales and use tax return or consumer use tax return that is timely filed with the Board.

The partial exemption certificate form set forth in Appendix A may be used to claim the partial exemption.

(e) REFUND OF PARTIAL EXEMPTION.

(1) For the period commencing on September 1, 2001, and ending on September 30, 2002, a qualified person may claim the partial exemption on qualified purchases from an in-state retailer or an out-of-state retailer obligated to collect the use tax by furnishing the retailer with a partial exemption certificate on or before December 31, 2002. The retailer must refund the tax or tax reimbursement directly to the qualified purchaser of qualified property or, at the purchaser's sole option, the purchaser may be credited with such amount. In the event that the retailer has already reported and paid the tax to the Board, the retailer must file a written claim for refund on or before January 31, 2003.

(2) A retailer who paid sales tax on a qualified sale or a person who paid use tax on a qualified purchase and who failed to claim the partial exemption as provided by this regulation may file a claim for refund equal to the amount of the partial exemption that he or she could have claimed pursuant to this regulation. The procedure for filing a claim shall be the same as for other claims for refund filed pursuant to Revenue and Taxation Code section 6901. For transactions subject to use tax, a qualified person filing a claim for refund of the partial exemption has the burden of establishing that he or she was entitled to claim the partial exemption with respect to the amount of refund claimed under this part. For transactions subject to sales tax, a person filing a claim for refund of the partial exemption has the burden of establishing that the purchaser of the qualified property otherwise met all the requirements of a qualified person at the time of the purchase subject to the refund claimed under this part.

(f) IMPROPER USE OF PARTIAL EXEMPTION.

(1) PROPERTY USED IN A MANNER NOT QUALIFYING FOR THE PARTIAL EXEMPTION.

Notwithstanding subdivision (a), tax applies to any sale of, or the storage, use, or other consumption in this state of tangible personal property that is used in a manner not qualifying for the partial exemption under this regulation.

(2) PURCHASES BY NON-QUALIFIED PERSONS. Notwithstanding subdivision (a), tax applies to any sale of, and the storage, use, or other consumption in this state of tangible personal property if a purchaser is not a qualified person.

(g) PURCHASER'S LIABILITY FOR THE PAYMENT OF SALES TAX.

(1) If a purchaser timely submits a copy of a partial exemption certificate to the retailer or partial exemption certificate for use tax to the Board, and then uses that tangible personal property in a manner not qualifying for the partial exemption, the purchaser shall be liable for payment of the sales tax, with applicable interest, to the same extent as if the purchaser were a retailer making a retail sale of the property at the time the property was so removed, converted, or used.

(2) A purchaser providing a partial exemption certificate accepted in good faith by the retailer or a partial exemption certificate for use tax to the Board for tangible personal property that does not qualify for the partial exemption is liable for payment of the sales tax, with applicable interest, to the same extent as if the purchaser were a retailer making a retail sale of the property at the time the property was purchased.

(h) LEASES TO QUALIFYING PERSONS.

(1) **LEASES—IN GENERAL.** Leases of tangible personal property which are classified as “continuing sales” and “continuing purchases” of tangible personal property, in accordance with Regulation 1660, “Leases of Tangible Personal Property – In General,” may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. This partial exemption may apply to rentals payable paid by a qualified person on or after September 1, 2001 with respect to a lease of qualified property to the qualified person, which qualified property is used for breeding purposes, notwithstanding the fact that the lease was entered into prior to the effective date of this regulation. For purposes of this subdivision, a non-qualified person may purchase property for resale and subsequently lease the property to a qualified person subject to the partial exemption.

(2) **LEASES—ACQUISITION SALE AND LEASEBACK.** A qualified person will be regarded as having paid sales tax reimbursement or use tax with respect to that qualified person's purchase of property, within the meaning of those words as they are used in section 6010.65 of the Revenue and Taxation Code, if the qualified person has paid all applicable taxes with respect to the acquisition of the property, notwithstanding the fact that the sale and purchase of the property may have been subject to the partial exemption from tax provided by this regulation.

(3) **SUBSEQUENT LEASE OF PROPERTY ACQUIRED SUBJECT TO PARTIAL EXEMPTION.** If a qualified person has acquired property subject to the partial exemption provided by this regulation and has paid all applicable taxes at that acquisition, the property will be regarded as property as to which sales tax reimbursement or use tax has been paid, and the subsequent lease of that property will not be subject to tax measured by rentals payable.

(i) **RECORDS.** Adequate and complete records must be maintained by the qualified person as evidence that the qualified property was capable of reproduction and purchased by the qualified person solely for breeding purposes.

(j) **EFFECTIVE DATE.** This regulation is effective as of September 1, 2001.

Draft

Appendix A

PARTIAL EXEMPTION CERTIFICATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Qualified sales and purchases of
Farm Equipment and Machinery Commercial Timber Harvesting Equipment and Machinery
Diesel Fuel for Farming Activities or Food Processing Racehorse Breeding Stock

NOTE: This is an exemption only from the state general fund portion of the sales and use tax rate (currently 4.75%). You are not relieved from your obligations for the local and district taxes on this transaction. This partial exemption also does not apply to any tax levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to Section 35 of article XIII of the California Constitution. This partial exemption also applies to lease payments made on or after September 1, 2001, for tangible personal property even if the lease agreement was entered into prior to September 1, 2001.

SELLER'S/LESSOR'S NAME
SELLER'S/LESSOR'S ADDRESS (Street, City, State, Zip Code)

PLEASE COMPLETE BOTH PARTS 1 AND 2 FOR CERTIFICATE TO BE CONSIDERED VALID

This partial exemption certificate applies to the following (check applicable box and complete as necessary):

P
A
R
T
1

- This is a blanket partial exemption certificate covering all purchases.
Effective date _____ (optional) Expiration date _____ (optional)
- This is a specific purchase partial exemption certificate.
Purchase order _____

IF NO BOX FOR PART 1 IS CHECKED, THIS CERTIFICATE SHALL BE DEEMED A SPECIFIC PURCHASE PARTIAL EXEMPTION

The undersigned purchaser hereby certifies that the tangible personal property identified below will be used by a qualified person, as applicable, and in the manner as specified below (check applicable box and complete as necessary):

P
A
R
T
2

- Farm Equipment and Machinery (and the parts thereof)** – I am engaged in business in an industry described in Codes 0111 to 0291 of the Standard Industrial Classification Manual, or I assist such classified persons. The property purchased or leased will be used primarily in producing and harvesting agricultural products in accordance with Revenue & Taxation Code Section 6356.5.
Type of Farm Equipment and Machinery (or parts thereof) _____
- Diesel Fuel Used in Farming Activities or Food Processing** – The _____ % of diesel fuel purchased will be used in qualified farming activities or food processing in accordance with Revenue & Taxation Code Section 6357.1.
- Commercial Timber Harvesting Equipment and Machinery (and the parts thereof)** – I am engaged in commercial timber harvesting. The property purchased or leased is primarily designed for off-road commercial timber harvesting and will be primarily used in timber harvesting in accordance with Revenue & Taxation Code Section 6356.6.
Type of Commercial Timber Harvesting Equipment and Machinery (or parts thereof) _____
- Racehorse Breeding Stock** – I have confirmed the racehorse is capable of reproduction and intend to use the racehorse solely for breeding purposes in accordance with Revenue & Taxation Code Section 6358.5.

I understand that if such property is not used in the manner qualifying for the partial exemption, or if I am not a qualified person, as applicable, that I am required by the Sales and Use Tax Law to report and pay the state tax measured by the sales price/rentals payable of the property to/by me. I also understand that this partial exemption certificate is in effect as of the date shown below or as of the effective date if indicated above and will remain in effect until revoked in writing or upon expiration if indicated above.

NOTE: Purchaser must provide a new certificate to the seller if any information in this certificate changes.

PURCHASER'S NAME		TITLE
SIGNATURE†		DATE
TELEPHONE NUMBER	COMPANY NAME	PERMIT NUMBER (If applicable)*
ADDRESS	CITY	STATE, ZIP

† If signature of other than the purchaser, I certify I have the authority to bind the purchaser.

*In California, you are required to hold a seller's permit if you are engaged in the business of selling tangible personal property that is subject to tax when sold at retail. Certain lessors must also hold a seller's permit. If you are not required to hold a seller's permit because you make no sales or leases of this type of property in California, please enter "not applicable" and the reason why you are not required to hold a permit.

Initial Discussion Paper

Proposed Regulation 1535. Racehorse Breeding Stock

Exhibit 2
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Attach a copy of the lease agreement.

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