

**AGENDA — June 19, 2002 Business Taxes Committee Meeting**  
***Regulation 1535, Race Horse Breeding Stock***

<p><b>Action 1 — Consent Items</b></p> <p>Proposed Regulation 1535, <i>Racehorse Breeding Stock</i> Agenda, pages 2 – 8</p>	<p>Adopt proposed Regulation 1535 as agreed upon by interested parties and staff.</p>
<p><b>Action 2 — Authorization to Publish</b></p>	<p>Recommend the publication of the proposed Regulation 1535, <i>Racehorse Breeding Stock</i>, as adopted in the above actions.</p> <p>Operative Date: September 1, 2001 Implementation: Implementation will take place 30 days following approval by the Office of Administrative Law.</p>

**AGENDA — June 19, 2002 Business Taxes Committee Meeting**  
**Regulation 1535, Race Horse Breeding Stock**

Action Item	Staff and Industry’s Proposed Regulatory Language
<p><b>Action 1 — Consent Items</b></p>	<p><u>(a) GENERAL. Commencing on and after September 1, 2001, section 6358.5 of the Revenue and Taxation Code partially exempts from sales and use tax the sale of, and the storage, use, or other consumption in this state, of racehorse breeding stock purchased for use by a qualified person. The terms “racehorse breeding stock” and “qualified person” are defined below.</u></p> <p><u>For the period commencing on September 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.</u></p> <p><u>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.</u></p> <p><b>(b) DEFINITIONS.</b> For purposes of this regulation:</p> <p><u>(1) “Qualified person” means a person who purchases racehorse breeding stock solely with the intent and purpose of breeding.</u></p> <p><u>(2) “Qualified property” means racehorse breeding stock, as defined in subdivision (b)(3).</u></p> <p><u>(3) “Racehorse breeding stock” means a live horse that meets all of the following criteria:</u></p> <p><u>(A) Is or will be eligible to participate in a horseracing contest in California wherein pari-mutuel wagering is permitted under rules and regulations prescribed by the California Horse Racing Board.</u></p>

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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><u>(B) Is capable of producing foals which will be eligible to participate in a horseracing contest in California wherein pari-mutuel wagering is permitted under rules and regulations prescribed by the California Horse Racing Board.</u></p> <p><u>(C) Is or was registered with an agency recognized by the California Horse Racing Board unless such agency deems the horse not eligible for breeding stock. Agencies currently recognized are The Jockey Club, The American Quarter Horse Association, The United States Trotting Association, The Appaloosa Horse Club, The Arabian Horse Registry of America, and the American Paint Horse Association.</u></p> <p><u>Racehorse breeding stock does not include any horse over four years old, or five years old in the case of an Arabian horse, that has neither participated in or trained for a horserace contest on which pari-mutuel wagering is permitted, nor been used for breeding purposes in order to produce racehorses.</u></p> <p><u>(4) “Solely” means 100 percent or “only.”</u></p> <p><b><u>(c) PARTIAL EXEMPTION CERTIFICATES.</u></b></p> <p><u>(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, as defined in subdivision (c)(5), 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, any time at or prior to delivery of the qualified property to the purchaser, or no later than 15 days after the date of purchase. 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. A partial exemption from the sales and use tax under this part shall not be allowed unless the retailer claims the partial exemption on its sales and use tax return for the reporting period during which the transaction subject to the partial exemption occurred. Where the retailer fails to claim the partial</u></p>
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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><u>exemption as set forth above, the retailer may file a claim for refund as set forth in subdivision (e). partial exemption from the sales and use tax under this part shall not be allowed unless the retailer claims the partial exemption on its sales and use tax return for the reporting period during which the transaction subject to the partial exemption occurred. Where the retailer fails to claim the partial exemption as set forth above, the retailer may file a claim for refund as set forth in subdivision (e).</u></p> <p><u>The partial exemption certificate form set forth in Appendix A may be used to claim the partial exemption.</u></p> <p><u>(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 partial exemption certificate form set forth in Appendix A may be used as a blanket partial exemption certificate. Appendix A may also be used as a specific partial exemption certificate if the purchaser provides the purchase order or sales invoice number of the property being purchased. Qualified persons must include in the 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.</u></p> <p><u>(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:</u></p> <p><u>(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.</u></p> <p><u>(B) The name, address and telephone number of the purchaser.</u></p> <p><u>(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.</u></p>
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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><u>(D) A statement that the property purchased is capable of reproduction.</u></p> <p><u>(E) A statement that the purchaser will use the property solely for the purpose of breeding.</u></p> <p><u>(F) A description of the property purchased.</u></p> <p><u>(G) Date of execution of the document.</u></p> <p><u>(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 partial exemption certificate.</u></p> <p><u>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 provide the Board access to any and all partial exemption certificates, or copies thereof, accepted for the purposes of supporting the partial exemption.</u></p> <p><u>(5) GOOD FAITH. A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person states that he or she is purchasing the qualified property solely with the intent and purpose of breeding. If the qualified person is buying a horse of a kind not normally used to breed racehorses, the seller should require a statement as to how the specific property purchased will be used. However, a partial exemption certificate cannot be accepted in good faith where the seller has knowledge that the property is not subject to the partial exemption, or will not be otherwise used in a partially exempt manner.</u></p>
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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><b><u>(d) PARTIAL EXEMPTION CERTIFICATE FOR USE TAX.</u></b> <u>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. A partial exemption from the use tax shall not be allowed unless the purchaser or retailer claims the partial exemption on its individual use tax return, sales and use tax return, or consumer use tax return for the reporting period during which the transaction subject to the partial exemption occurred. Where the purchaser or retailer fails to claim the partial exemption as set forth above, the purchaser or retailer may file a claim for refund as set forth in subdivision (e).</u></p> <p><u>The purchaser who files an individual use tax return must attach a completed partial exemption certificate to the return. The purchaser who is registered with the Board as a retailer or consumer and files a sales and use tax return or consumer use tax return must, within 45 days of the Board's request, provide the Board access to any and all documents that support the claimed partial exemption.</u></p> <p><u>The partial exemption certificate form set forth in Appendix A may be used to claim the partial exemption.</u></p> <p><b><u>(e) REFUND OF PARTIAL EXEMPTION.</u></b></p> <p><u>(1) For the period commencing on September 1, 2001, and ending on December 31, 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 March 31, 2003. 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.</u></p> <p><u>(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</u></p>
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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><u>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.</u></p> <p><b><u>(f) IMPROPER USE OF PARTIAL EXEMPTION.</u></b></p> <p><u>(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.</u></p> <p><u>(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.</u></p> <p><b><u>(g) PURCHASER'S LIABILITY FOR THE PAYMENT OF SALES TAX.</u></b></p> <p><u>(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.</u></p> <p><u>(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.</u></p>
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<p><b>Action 1 — Consent Items</b> (Continued)</p>	<p><b><u>(h) LEASES TO QUALIFYING PERSONS.</u></b></p> <p><u>(1) LEASES—IN GENERAL.</u> 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.</p> <p><u>(2) LEASES—ACQUISITION SALE AND LEASEBACK.</u> 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.</p> <p><u>(3) SUBSEQUENT LEASE OF PROPERTY ACQUIRED SUBJECT TO PARTIAL EXEMPTION.</u> 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.</p> <p><u>(i) RECORDS.</u> 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.</p> <p><u>(j) OPERATIVE DATE.</u> This regulation is operative as of September 1, 2001.</p>
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Formal Issue Paper Number 02-011

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**Appendix A**

**PARTIAL EXEMPTION CERTIFICATE**

**STATE BOARD OF EQUALIZATION**

Qualified Sales and Purchases of Racehorse Breeding Stock

**NOTE:** This is an exemption only from the state general fund portion of the sales and use tax rate. 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.

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

I, as the undersigned purchaser, hereby certify that I have confirmed the racehorse is capable of reproduction and that I intend to use the racehorse solely for breeding purposes in accordance with Revenue & Taxation Code section 6358.5.

If you also want this certificate to be used as a blanket certificate for future purchases, ask your vendor to keep this certificate on file. If this is a specific partial exemption certificate, provide the purchase order or sales invoice number of the property being purchased.

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, 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 and will remain in effect until revoked in writing.

<u>PURCHASER'S NAME OR COMPANY NAME (if applicable)</u>		<u>DATE</u>
<u>SIGNATURE (signature of the purchaser, purchaser's employee, or authorized representative of the purchaser)</u>		<u>PERMIT NUMBER (if applicable)<sup>1</sup></u>
<u>TITLE</u>		<u>TELEPHONE NUMBER</u>
<u>ADDRESS</u>	<u>CITY</u>	<u>STATE, ZIP</u>

<sup>1</sup> If you are not required to hold a seller's permit, please enter "Not applicable."

Issue Paper Number 02 - 011



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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## **PROPOSED REGULATION 1535, PARTIAL EXEMPTION FROM TAX ON THE SALES AND USE OF RACEHORSE BREEDING STOCK**

### **I. Issue**

Should the Board adopt a proposed regulation for implementing the provisions of Assembly Bill 426 regarding a partial exemption from tax on the sale or use of racehorse breeding stock?

### **II. Staff Recommendation**

As agreed upon by staff and industry representatives, staff recommends that the Board authorize publication of the proposed Regulation 1535, *Racehorse Breeding Stock*, as illustrated in Exhibit 3. Staff recommends regulatory language that implements, interprets, and makes specific the provisions of Revenue and Taxation Code (RTC) section 6358.5 including the following:

- Includes a brief overview of the general provisions of the partial exemption. (See Agenda action item 1.)
- Provides a definition of “racehorse breeding stock.” (See Issue Paper (IP) pages 3-4, and Agenda action item 1.)
- Provides requirements for issuing a partial exemption certificate. (See IP pages 4-5, and Agenda action item 1.)
- Clarifies procedures for claiming a refund of the partial exemption. (See IP pages 4-5, and Agenda action item 1.)
- Clarifies improper use of partial exemption certificate and resultant liable party (es). (See IP page 5, and Agenda action item 1.)
- Provides clarification 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. (See IP page 5, and Agenda action item 1.)

The provisions of this regulation have an operative date of September 1, 2001.

### **III. Other Alternative(s) Considered**

Do not adopt proposed Regulation 1535, *Racehorse Breeding Stock*.

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## **IV. 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 the sales and purchases of racehorse breeding stock, AB 2757 would have exempted from the sales and use tax, gross receipts attributable to fees for stallion services, sales of thoroughbred horses less than two years of age to an out-of-state resident that are transported outside California, fees for 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 contended that the exemption could ultimately increase state tax revenues as it would promote racehorse breeding in the state. If this occurred, 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 sold for racing purposes 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 from tax on the sales and purchases of racehorse breeding stock. See Exhibit 3.

This partial tax exemption applies to only the state portion of the tax (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.

The Business Taxes Committee is scheduled to discuss this issue at its meeting on June 16, 2002.

## **V. Staff Recommendation**

### **A. Description of the Staff Recommendation**

Staff recommends the adoption of proposed Regulation 1535, *Racehorse Breeding Stock*, as illustrated in Exhibit 3. The proposed language provides definitions of terms used in the statute and clarification with respect to the application of the partial exemption to sales and use of racehorse breeding stock. The proposed regulation has an operative date of September 1, 2001. All changes to the proposed text made since the regulation was distributed with staff's Second Discussion Paper are noted in underline (additions) and strike through (deletions) format.

**FORMAL ISSUE PAPER**Issue Paper Number 02 - 011**Regulation 1535(b), Definitions**

Subdivision (b) provides definitions of terms used in the statute that are essential to administering the provisions of the partial exemption as set forth in RTC section 6358.5. Essentially, “racehorse breeding stock” means a live horse that meets all of the following: (A) Is or will be eligible to participate in a horseracing contest in California wherein pari-mutuel wagering is permitted under rules and regulations prescribed by the California Horse Racing Board (CHRB); (B) Is capable of producing foals which will be eligible to participate in a horseracing contest in California wherein pari-mutuel wagering is permitted under rules and regulations prescribed by the CHRB; and (C) Is or was registered with an agency recognized by the CHRB unless such agency deems the horse not eligible for breeding stock (agencies currently recognized are: The Jockey Club, The American Quarter Horse Association, The United States Trotting Association, The Appaloosa Horse Club, The Arabian Horse Registry of America, and the American Paint Horse Association). Nevertheless, racehorse breeding stock does not include any horse over four years old, or five years old in the case of an Arabian horse, that has neither participated in or trained for a horserace contest in which pari-mutuel wagering is permitted, nor been used for breeding purposes in order to produce racehorses. The latest changes to the proposed definition of “racehorse breeding stock” make eligible for the partial exemption horses over four years old, or five years old in the case of Arabian horses, that may not have raced or bred, but have trained for a horserace contest in which pari-mutuel wagering is permitted.

**Regulation 1535 subdivisions (c) Partial Exemption Certificates, (d) Partial Exemption Certificate for Use Tax, and (e) Refund of Partial Exemption**

Staff proposes language in paragraphs (c) through (e) to mirror those provisions included in Regulations 1533, 1533.1 and 1533.2 that implement the statutes enacted as part of AB 426 pertaining to liquefied petroleum gas, farm equipment and machinery, and diesel fuel. Specifically, staff proposes language to explain the use of partial exemption certificates. In general, retailers who take a partial exemption certificate timely and in good faith from a customer are relieved from the liability for the sales or use tax subject to the partial 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. A partial exemption certificate may also be considered timely if taken no later than 15 days after the date of purchase. If the retailer fails to obtain a timely partial 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. Language has been proposed to include a presumption that a retailer has accepted an exemption certificate in good faith in the absence of evidence to the contrary. Moreover due to the short implementation time allowed to enact the provisions of the statute, the proposed regulation is not expected to be adopted until several months following the operative date. Although the statute requires that a partial exemption certificate be issued in a timely manner, staff proposes regulatory language that provides a limited period of time within which a qualified person may provide its vendor with a partial exemption certificate which would not otherwise be considered timely.

**Regulation 1535 subdivisions (f) Improper Use of Partial Exemption and (g) and Purchaser’s Liability for the Payment of Sales Tax**

The partial exemption provided in RTC section 6358.5 applies to the sale and use of racehorse breeding stock purchased for use by a qualified person to be used solely for breeding purposes. Therefore, tax applies to property that is not used in a qualifying manner or is not purchased by a qualified person.

In cases where the purchaser furnishes a valid partial exemption certificate to the retailer or the Board (as applicable) the purchaser is liable for the payment of tax if the property is used in a manner not qualifying for the

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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.

**Regulation 1535(h), Leases to Qualifying Persons**

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.

**Regulation 1535(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.

**B. Pros of the Staff Recommendation**

- Provides clear definitions of terms used in the statute.
- Provides requirements for issuing a partial exemption certificate and an example of an acceptable format for a partial exemption certificate.

**C. Cons of the Staff Recommendation**

None.

**D. Statutory or Regulatory Change**

No statutory change is required. Staff proposes that a new regulation be adopted.

**E. Administrative Impact**

Staff will need to notify taxpayers about the new regulation and will do so through a Tax Information Bulletin article.

**F. Fiscal Impact****1. Cost Impact**

The costs associated with the distribution of Tax Information Bulletins, which are routinely prepared and distributed to taxpayers, are accommodated within the Board’s existing budget. There are no other costs.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

**G. Taxpayer/Customer Impact**

Since the proposed regulation provides clear guidance to taxpayers regarding the partial exemption, staff expects that this regulation will improve compliance.

**H. Critical Time Frames**

The provisions of the proposed regulation are operative September 1, 2001. Implementation will occur 30 days after approval by the Office of Administrative Law.

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## **VI. Alternative 1**

### **A. Description of Alternative 1**

Do not adopt proposed Regulation 1535, *Racehorse Breeding Stock*.

### **B. Pros of Alternative 1**

No regulatory change is required.

### **C. Cons of Alternative 1**

There would be no regulatory language to provide clear definitions of terms used in the statute and no requirements for issuing a partial exemption certificate or example of an acceptable format for a partial exemption certificate.

### **D. Statutory or Regulatory Change**

None.

### **E. Administrative Impact**

None.

### **F. Fiscal Impact**

#### **1. Cost Impact**

None.

#### **2. Revenue Impact**

See Revenue Estimate (Exhibit 1).

### **G. Taxpayer/Customer Impact**

None.

### **H. Critical Time Frames**

None.

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

Current as of: May 28, 2002

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**REVENUE ESTIMATE**

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION



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**PROPOSED REGULATION 1535, PARTIAL EXEMPTION FROM  
TAX ON THE SALE AND USE OF RACEHORSE BREEDING  
STOCK**

**Recommendation and Alternatives**

**Staff Recommendation:**

As agreed upon by staff and industry representatives, staff recommends that the Board authorize publication of the proposed Regulation 1535, *Racehorse Breeding Stock*, as illustrated in Exhibit 3 of the issue paper. Staff recommends regulatory language that implements, interprets, and makes specific the provisions of Revenue and Taxation Code (RTC) section 6358.5 including the following:

- Includes a brief overview of the general provisions of the partial exemption.
- Provides a definition of “racehorse breeding stock”.
- Provides requirements for issuing a partial exemption certificate.
- Clarifies procedures for claiming a refund of the partial exemption.
- Clarifies improper use of partial exemption certificate and resultant liable party (es).
- Provides clarification 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.

The provisions of this regulation have an operative date of September 1, 2001.

**Alternative 1:**

Do not adopt proposed Regulation 1535, *Racehorse Breeding Stock*.

## **Background, Methodology, and Assumptions**

### **Staff Recommendation:**

Staff recommends the adoption of proposed Regulation 1535, *Racehorse Breeding Stock*. The proposed language provides definitions of terms used in the statute and clarification with respect to the application of the partial exemption as it applies to racehorse breeding stock. This regulatory language is provided to implement certain statutory provisions of AB 426, Chapter 156 (2001). The revenue impact outlined in this estimate is due to the passage of this statute.

The total annual expenditures exempted by AB 426 as reflected in the staff recommendation are estimated to be \$77.2 million. This estimate is based on information from the California Horse Racing Board (CHRB) and includes both sales by agencies recognized by the CHRB and sales of racehorses at California claiming races. This exemption is from the state sales and use tax and would result in a revenue loss of \$3.9 million annually.

### **Alternative 1:**

Alternative 1 has no revenue effect.

## **Revenue Summary**

### **Staff Recommendation:**

The revenue effect of those provisions of AB 426, Chapter 156 (2001) as implemented by the regulation recommended by staff is estimated to be \$3.9 million annually.

### **Alternative 1:**

Alternative 1 has no revenue effect.

## **Preparation**

This revenue estimate was prepared by David E. Hayes, Research and Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Margaret Shedd, Legislative Counsel and Ms. Charlotte Paliani, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of May 28, 2002

**Revenue and Taxation Code Section 6358.5**  
**As Added 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.

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 partially exempts from sales and use tax the sale of, and the storage, use, or other consumption in this state, of racehorse breeding stock purchased for use by a qualified person. The terms “racehorse breeding stock” and “qualified person” are defined below.

For the period commencing on September 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 criteria:

**(A)** Is or will be eligible to participate in a horseracing contest in California wherein pari-mutuel wagering 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 wagering 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 unless such agency deems the horse not eligible for breeding stock. 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, and the American Paint Horse Association.

Racehorse breeding stock does not include any horse over ~~four~~<sup>three</sup> years old, or ~~four~~<sup>five</sup> years old in the case of an Arabian horse, that has neither participated in or trained for a horserace contest on which pari-mutuel wagering is permitted, nor been used for breeding purposes in order to produce racehorses, ~~during the two previous calendar years~~. ~~A horse used for breeding purposes means 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.~~

(4) “Solely” means 100 percent 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, as defined in subdivision (c)(5), 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, any time at or prior to delivery of the qualified property to the purchaser, or no later than 15 days after the date of purchase. 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. A partial exemption from the sales and use tax under this part shall not be allowed unless the retailer claims the partial exemption on its sales and use tax return for the reporting period during which the transaction subject to the partial exemption occurred. Where the retailer fails to claim the partial exemption as set forth above, the retailer may file a claim for refund as set forth in subdivision (e).

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 partial exemption certificate form set forth in Appendix A may be used as a blanket partial exemption certificate. Appendix A may also be used as a specific partial exemption certificate if the purchaser provides the purchase order or sales invoice number of the property being purchased. Qualified persons must include in the 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 partial 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 provide the Board access to any and all partial exemption certificates, or copies thereof, accepted for the purposes of supporting the partial exemption.

(5) **GOOD FAITH.** A seller will be presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. A seller, without knowledge to the contrary, may accept a partial exemption certificate in good faith where a qualified person states that he or she is purchasing the qualified property solely with the intent and purpose of breeding. If the qualified person is buying a horse of a kind not normally used to breed racehorses, the seller should require a statement as to how the specific property purchased will be used. However, a partial exemption certificate cannot be accepted in good faith where the seller has knowledge that the property is not subject to the partial exemption, or will not be otherwise used in a partially exempt manner.

(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. A partial exemption from the use tax shall not be allowed unless the purchaser or retailer claims the partial exemption on its individual use tax return, sales and use tax return, or consumer use tax return for the reporting period during which the transaction subject to the partial exemption

occurred. Where the purchaser or retailer fails to claim the partial exemption as set forth above, the purchaser or retailer may file a claim for refund as set forth in subdivision (e).

The purchaser who files an individual use tax return must attach a completed partial exemption certificate to the return. The purchaser who is registered with the Board as a retailer or consumer and files a sales and use tax return or consumer use tax return must, within 45 days of the Board's request, provide the Board access to any and all documents that support the claimed partial exemption.

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 December 31, 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 March 31, 2003. 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.

(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) **OPERATIVE DATE.** This regulation is operative as of September 1, 2001.

Appendix A

PARTIAL EXEMPTION CERTIFICATE

STATE BOARD OF EQUALIZATION

Qualified Sales and Purchases of Racehorse Breeding Stock

**NOTE:** This is an exemption only from the state general fund portion of the sales and use tax rate. 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)

I, as the undersigned purchaser, hereby certify that I have confirmed the racehorse is capable of reproduction and that I intend to use the racehorse solely for breeding purposes in accordance with Revenue & Taxation Code section 6358.5.

If you also want this certificate to be used as a blanket certificate for future purchases, ask your vendor to keep this certificate on file. If this is a specific partial exemption certificate, provide the purchase order or sales invoice number of the property being purchased.

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, 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 and will remain in effect until revoked in writing.

PURCHASER'S NAME OR COMPANY NAME (if applicable)		DATE
SIGNATURE (signature of the purchaser, purchaser's employee, or authorized representative of the purchaser)		PERMIT NUMBER (if applicable) <sup>1</sup>
TITLE		TELEPHONE NUMBER
ADDRESS	CITY	STATE, ZIP

<sup>1</sup> If you are not required to hold a seller's permit, please enter "Not applicable."