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February 14, 2014

To Interested Parties:

**Notice of Proposed Regulatory Action**  
**The State Board of Equalization Proposes to Adopt Amendments to**  
**California Code of Regulations, Title 18,**  
**Section 1655, *Returns, Defects and Replacements***

**NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1655, *Returns, Defects and Replacements*, which incorporate and implement, interpret, and make specific amendments made to Civil Code sections 1793.2 and 1793.25, by Assembly Bill No. 242 (AB 242) (Stats. 2011, ch. 727). The amendments to these sections require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the use tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to California's "Lemon Law."

The proposed amendments to Regulation 1655, subdivision (b)(2)(A) incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D) by specifying that the term buyer includes a lessee of a new motor vehicle. The proposed amendments to Regulation 1655, subdivisions (b)(2)(B) and (C) add "or use" tax where the current regulation refers to "sales tax or sales tax reimbursement." The proposed amendments to Regulation 1655, subdivision (b)(2)(B) add "or lease" after "sales" where the current regulation refers to "sales agreement" and after "sale" where the current regulation refers to "retail sale." The proposed amendments to Regulation 1655, subdivision (b)(2)(B) add "or lessor" after "dealer" where the current regulation refers to "the buyer and the dealer" and "the seller's permit number of the dealer." The proposed amendments revise and reformat the last sentence in Regulation 1655, subdivision (b)(2)(B) to require a manufacturer, when filing a claim for refund, to include "evidence of one of the following" from a list of proof that: (1) "The dealer had reported and paid sales tax on the

gross receipts from that sale”; (2) ”The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) “The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of the vehicle.” The proposed amendments also add a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

## **PUBLIC HEARING**

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on April 22-24, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board’s Website at [www.boe.ca.gov](http://www.boe.ca.gov) at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on April 22, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1655.

## **AUTHORITY**

RTC section 7051

## **REFERENCE**

RTC sections 6006-6012, and 6012.3; Civil Code sections 1793.2-1793.25; Vehicle Code sections 11713.12 and 11713.21

## **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

### Current Law

#### *General*

The Song-Beverly Consumer Warranty Act (commencing with Civ. Code, § 1790) contains provisions that provide warranty protections to purchasers of both new and used consumer goods. The act includes provisions (Civ. Code §§ 1793.2 - 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California’s “Lemon Law.” The Lemon Law provides, in relevant part, that if a manufacturer or its representative in this state, such as an authorized dealer, is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer is required to either promptly replace the vehicle or make restitution to the buyer. (Civ. Code, § 1793.2, subd. (d)(2).)

Under the existing Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant here, a “sale” and a “purchase.” (Rev. & Tax. Code, §§ 6006, 6010.) For a lease that is a “sale” and a “purchase,” the tax is measured by the rentals payable. However, as provided in subdivision (c)(1) of Regulation 1660, *Leases of Tangible Personal Property – In General*, the applicable tax is generally use tax, not sales tax, and the lessor is required to collect the use tax from the lessee at the time the amount of rent is paid and give him or her a receipt as prescribed in Regulation 1686, *Receipts for Tax Paid to Retailers*. The lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

The Lemon Law originally provided that in the case of restitution, a manufacturer was required to make restitution in an amount equal to the actual price paid or payable by the buyer, including, among other collateral charges, *sales tax*. (Civ. Code, § 1793.2.) The Lemon Law further required the Board to reimburse the manufacturer for an amount equal to the *sales tax* which the manufacturer paid to or for a buyer when providing a replacement vehicle or included in making restitution to the buyer when satisfactory proof was provided that the retailer of the motor vehicle for which the manufacturer was making restitution had reported and paid the sales tax on the gross receipts from the sale, and that the manufacturer had complied with the requirements of Civil Code section 1793.23, subdivision (c). However, the Lemon Law was silent with respect to whether restitution was required to include *use tax* and whether the Board was required to reimburse a manufacturer for use tax paid to or for a buyer or lessee or included in restitution paid to a buyer or lessee.

As relevant here, AB 242 amended the Lemon Law, specifically Civil Code sections 1793.2 and 1793.25, to make technical corrections sponsored by the Board. The amendments clarify that restitution, under the Lemon Law, includes *use tax* paid or payable by a buyer, including a lessee, of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use tax* that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to the Lemon Law. And, AB 242 provides that the Board-sponsored amendments to the Lemon Law are declaratory of existing law. (AB 242, § 21.)

In the case of restitution, Civil Code section 1793.2, subdivision (d)(2)(B) now provides, in relevant part, that the manufacturer shall make restitution in an amount equal to the actual price paid or payable by the buyer, including any collateral charges “such as sales or use tax.” And, Civil Code section 1793.2, subdivision (d)(2)(D) now specifies that “Pursuant to Section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

With respect to reimbursement, Civil Code section 1793.25, subdivision (a) now expressly requires the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to “the sales tax or use tax” which the manufacturer pays to or for the buyer “or lessee” when providing a replacement vehicle or includes in making restitution to the buyer “or lessee” under the Lemon Law, and, as a condition to receiving reimbursement, requires a manufacturer to provide satisfactory proof for one of the following:

- The retailer of the motor vehicle for which the manufacturer is making restitution has reported and paid the sales tax on the gross receipts from the sale of that motor vehicle.
- The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state.
- The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of that motor vehicle.

Also, Civil Code section 1793.25, subdivision (e) now provides that “The amount of use tax that the State Board of Equalization is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee” under the Lemon Law.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1655

*Need for Clarification*

Subdivision (b)(2) of Regulation 1655 explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement included in restitution paid to a buyer under the Lemon Law. However, Regulation 1655 does not indicate that AB 242 clarified that, under the Lemon Law, restitution includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle and required the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or includes in making restitution to a buyer or lessee, under the Lemon Law. Therefore, the Board’s Business Taxes Committee (BTC) staff determined that amendments to Regulation 1655 are needed in order to make the regulation consistent with and implement, interpret, and make specific AB 242’s amendments to the Lemon Law set forth above.

*Interested Parties Process*

As a result of AB 242, BTC staff drafted amendments to Regulation 1655. Specifically, the draft amendments suggested adding language to Regulation 1655, subdivision (b)(2)(A) to incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D), by specifying that, for purposes of Regulation 1655, the term buyer includes a lessee of a new motor vehicle. The draft amendments suggested adding “or use” tax to where the current regulation refers to “sales tax or sales tax reimbursement” in subdivision (b)(2)(B) and (C). The draft amendments suggested adding “or lease” after “sales” where the current regulation refers to “sales agreement” and after “sale” where the current regulation refers to “retail sale” in subdivision (b)(2)(B). The draft amendments also suggested adding “or lessor” after “dealer” where the current regulation refers to “the buyer and the dealer” and “the seller’s permit number of the dealer” in subdivision (b)(2)(B).

In addition, the draft amendments suggested revising and reformatting the last sentence in Regulation 1655, subdivision (b)(2)(B), which currently requires a manufacturer, when filing a claim for refund for sales tax or sales tax reimbursement included in restitution paid to a buyer,

to submit evidence that the dealer who made the retail sale of the non-conforming vehicle to that buyer reported and paid sales tax on the gross receipts from that sale. The revised and reformatted sentence requires a manufacturer, when filing a claim for refund for sales or use tax or sales tax reimbursement included in restitution paid to a buyer, including a lessee, under the Lemon Law, to provide “evidence of one of the following” from a list that includes proof that: (1) “The dealer had reported and paid sales tax on the gross receipts from that sale”; (2) “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of the vehicle.” The draft amendments also suggested adding a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

BTC staff subsequently prepared a discussion paper regarding the amendments made to the Lemon Law by AB 242 and staff’s draft amendments to Regulation 1655, provided the discussion paper and its draft amendments to Regulation 1655 to the interested parties, and conducted an interested parties meeting on August 8, 2013, to discuss the draft amendments to Regulation 1655. During the interested parties meeting, a participant inquired as to how the provisions of Regulation 1655 would apply to a transaction in which a lessor paid tax at the time the lessor purchased a vehicle which the lessor would then lease. Staff considered the scenario and, subsequent to the meeting, staff explained to the participant that in the event a lessor purchases a vehicle in this state tax paid, the transaction would generally be subject to sales tax and the dealer would likely collect sales tax reimbursement from the lessor. (See Reg. 1660, subd. (c)(2) and (3), regarding property purchased tax-paid and leased in substantially the same form as acquired.) And, staff explained that, with respect to sales tax transactions, the existing provisions of Regulation 1655 would apply to a manufacturer’s claim for a refund for sales tax reimbursement the manufacturer included in restitution paid to a lessor, under the Lemon Law. Furthermore, staff noted that AB 242 did not change the application of the Lemon Law to sales tax transactions, and that questions regarding the application of Regulation 1655 to sales tax transactions were beyond the scope of the current interested parties process, which was to discuss the issue of whether to amend Regulation 1655 to clarify the new provisions of the Lemon Law applicable to use tax transactions.

Since BTC staff did not receive any other inquiries or comments regarding its draft amendments during or subsequent to the first interested parties meeting and staff had no changes to its recommendation to amend Regulation 1655, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff’s draft amendments. Staff also notified interested parties that comments could be submitted up to October 17, 2013, for consideration in the preparation of a Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

*December 17, 2013, BTC Meeting*

Subsequently, staff prepared Formal Issue Paper 13-012 and distributed it to the Board Members for consideration at the Board's December 17, 2013, BTC meeting. Formal Issue Paper 13-012 recommended that the Board approve and authorize publication of the amendments to Regulation 1655 (discussed above) in order to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle (as provided in Civ. Code, § 1793.2, subd. (d)(2)(D), as added by AB 242).
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund (consistent with Civ. Code, § 1793.25, subd. (a), as amended by AB 242).
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee (as provided in Civ. Code, § 1793.25, subd. (e), as added by AB 242).

During the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1655 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1655 are reasonably necessary to have the effect and accomplish the objective of making the regulation consistent with and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1655 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1655 is the only state regulation prescribing the requirements for the Board to reimburse a manufacturer under Civil Code section 1793.25. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1655 or the proposed amendments to Regulation 1655.

**NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that the adoption of the proposed amendments to Regulation 1655 will not impose a mandate on local agencies or school districts, including a mandate that is

required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

**NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS**

The Board has determined that the adoption of the proposed amendments to Regulation 1655 will result in no direct or indirect cost or savings to any state agency, cost to any local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

**NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1655 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1655 may affect small business.

**NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

**RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1655 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1655 will not affect the benefits of Regulation 1655 to the health and welfare of California residents, worker safety, or the state's environment.

**NO SIGNIFICANT EFFECT ON HOUSING COSTS**

The adoption of the proposed amendments to Regulation 1655 will not have a significant effect on housing costs.

## **DETERMINATION REGARDING ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

## **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Monica Gonzalez Silva, Tax Counsel III, by telephone at (916) 323-3138, by e-mail at [Monica.Silva@boe.ca.gov](mailto:Monica.Silva@boe.ca.gov), or by mail at State Board of Equalization, Attn: Monica Gonzalez Silva, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## **WRITTEN COMMENT PERIOD**

The written comment period ends at 10:00 a.m. on April 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1655 during the April 22-24, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1655. The Board will only consider written comments received by that time.

## **AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an underscored and strikethrough version of the text of Regulation 1655 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1655, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed

amendments and the initial statement of reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

**SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt the proposed amendments to Regulation 1655 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

**AVAILABILITY OF FINAL STATEMENT OF REASONS**

If the Board adopts the proposed amendments to Regulation 1655, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov)

Sincerely,

  
Joann Richmond, Chief  
Board Proceedings Division

JR:reb

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**STATE BOARD OF EQUALIZATION**



BOARD APPROVED

At the April 22, 2014 Board Meeting

  
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Joann Richmond, Chief  
Board Proceedings Division

**Initial Statement of Reasons for  
Proposed Amendments to California Code of Regulations,  
Title 18, Section 1655, *Returns, Defects and Replacements***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

General Background

The Song-Beverly Consumer Warranty Act (commencing with Civ. Code, § 1790) contains provisions that provide warranty protections to purchasers of both new and used consumer goods. The act includes provisions (Civ. Code, §§ 1793.2 - 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California’s “Lemon Law.” As relevant here, the Lemon Law provides that if the manufacturer or its representative is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer shall either promptly replace the new motor vehicle or promptly make restitution to the buyer. (Civ. Code, § 1793.2, subd. (d)(2).)

Under the existing Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant here, a “sale” and a “purchase.” (Rev. & Tax. Code, §§ 6006, 6010.) For a lease that is a “sale” and a “purchase,” the tax is measured by the rentals payable. However, as provided in subdivision (c)(1) of California Code of Regulations, title 18, section (Regulation) 1660, *Leases of Tangible Personal Property – In General*, the applicable tax is generally use tax, not sales tax, and the lessor is required to collect the use tax from the lessee at the time the amount of rent is paid and give him or her a receipt as prescribed in Regulation 1686, *Receipts for Tax Paid to Retailers*. The lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

The Lemon Law originally provided that in the case of restitution, a manufacturer was required to make restitution in an amount equal to the actual price paid or payable by the buyer, including, among other collateral charges, *sales tax*. (Civ. Code, § 1793.2.) The Lemon Law further required the State Board of Equalization (Board) to reimburse the manufacturer for an amount equal to the *sales tax* which the manufacturer paid to or for a buyer when providing a replacement vehicle or included in making restitution to the buyer when satisfactory proof was provided that:

- The retailer of the motor vehicle for which the manufacturer was making restitution had reported and paid the sales tax on the gross receipts from the sale of that motor vehicle; and
- The manufacturer complied with Civil Code section 1793.23, subdivision (c), which pertains to inscribing the ownership certificate of a reacquired vehicle with the notation

“Lemon Law Buyback” and affixing a decal to the vehicle regarding the notation on the ownership certificate. (Civ. Code, § 1793.25.)

However, the Lemon Law was silent with respect to whether restitution was required to include *use* tax and whether the Board was required to reimburse a manufacturer for use tax paid to or for a buyer or lessee or included in restitution paid to a buyer or lessee.

Assembly Bill No. 242 (AB 242) (Stats. 2011, ch. 727, §§ 1 and 2) amended the Lemon Law, specifically Civil Code sections 1793.2 and 1793.25, to make technical corrections sponsored by the Board. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to the Lemon Law. And, AB 242 provides that the Board-sponsored amendments to the Lemon Law are declaratory of existing law. (AB 242, § 21.)

#### *Civil Code section 1793.2*

With respect to Civil Code section 1793.2, AB 242 specifically:

- Amended subdivision (d)(2)(B) to add “use tax” to the collateral charges which a buyer is entitled to receive in cases of restitution; and
- Added subdivision (d)(2)(D) to specify that “[p]ursuant to section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

Therefore, in the case of restitution, Civil Code section 1793.2, subdivision (d)(2)(B) and (D), currently provides, in relevant part, that the manufacturer shall make restitution in an amount equal to the actual price paid or payable by the buyer or lessee, including any collateral charges such as “sales or use tax.”

#### *Civil Code section 1793.25*

With respect to Civil Code section 1793.25 and as relevant here, AB 242 specifically:

- Amended subdivision (a) to specify the Board shall reimburse the manufacturer of a new motor vehicle for an amount equal to the sales tax “or use tax” which the manufacturer pays to or for the buyer “or lessee” when providing a replacement vehicle or includes in making restitution to the buyer “or lessee” under the Lemon Law;
- Expanded the satisfactory proof that tax was paid, under subdivision (a), to include proof that:
  - “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or
  - “The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of that motor vehicle”; and
- Added subdivision (e) which specifies that “the amount of use tax that the [Board] is required to reimburse the manufacturer shall be limited to the amount of use tax the

manufacturer is required to pay to or for the lessee pursuant to [Civil Code] section 1793.2.”

As a result, Civil Code section 1793.25, subdivision (a), currently provides, in relevant part, that the Board shall reimburse a manufacturer for an amount equal to the sales or use tax which the manufacturer pays to or for a buyer or lessee when providing a replacement vehicle, or includes in making restitution to the buyer or lessee. Also, in order to obtain reimbursement, subdivision (a) currently requires a manufacturer to provide satisfactory proof that it complied with Civil Code subdivision 1793.23, subdivision (c), which pertains to inscribing the ownership certificate of a reacquired vehicle with the notation “Lemon Law Buyback” and affixing a decal to the vehicle regarding the notation on the ownership certificate. And, subdivision (a) requires a manufacture to provide satisfactory proof for one of the following:

- The retailer of the motor vehicle for which the manufacturer is making restitution has reported and paid the sales tax on the gross receipts from the sale of that motor vehicle.
- The buyer of the motor vehicle has paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state.
- The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of that motor vehicle.

#### Proposed Amendments

##### *Need for Clarification*

Subdivision (b)(2) of Regulation 1655, *Returns, Defects and Replacements*, explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement<sup>1</sup> included in restitution paid to a buyer under the Lemon Law. However, there is an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)) because Regulation 1655 does not indicate that AB 242 made amendments to Civil Code sections 1793.2 and 1793.25 to make clear that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or includes in making restitution to a buyer or lessee, under the Lemon Law. Therefore, the Board’s Business Taxes Committee (BTC) staff determined that amendments to Regulation 1655 are needed in order to make Regulation 1655 consistent with and implement, interpret, and make specific the amendments to the Lemon Law made by AB 242 (discussed above).

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<sup>1</sup> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers, as explained in Regulation 1700, *Reimbursement for Sales Tax*.

### *Interested Parties Process*

As a result of AB 242, BTC staff drafted amendments to Regulation 1655. Specifically, the draft amendments suggested adding language to Regulation 1655, subdivision (b)(2)(A) to incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D), by specifying that, for purposes of Regulation 1655, the term buyer includes a lessee of a new motor vehicle. The draft amendments suggested adding “or use” tax to where the current regulation refers to “sales tax or sales tax reimbursement” in subdivision (b)(2)(B) and (C). The draft amendments suggested adding “or lease” after “sales” where the current regulation refers to “sales agreement” and after “sale” where the current regulation refers to “retail sale” in subdivision (b)(2)(B). The draft amendments also suggested adding “or lessor” after “dealer” where the current regulation refers to “the buyer and the dealer” and “the seller’s permit number of the dealer” in subdivision (b)(2)(B).

In addition, the draft amendments suggested revising and reformatting the last sentence in Regulation 1655, subdivision (b)(2)(B), which currently requires a manufacturer, when filing a claim for refund for sales tax or sales tax reimbursement included in restitution paid to a buyer, to submit evidence that the dealer who made the retail sale of the non-conforming motor vehicle to that buyer reported and paid sales tax on the gross receipts from that sale. The revised and reformatted sentence requires a manufacturer, when filing a claim for refund for sales or use tax or sales tax reimbursement included in restitution paid to a buyer, including a lessee, under the Lemon Law, to provide “evidence of one of the following” from a list that includes proof that: (1) “The dealer had reported and paid sales tax on the gross receipts from that sale”; (2) “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) “The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of the vehicle.” The draft amendments also suggested adding a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

BTC staff subsequently prepared a discussion paper regarding the amendments made to the Lemon Law by AB 242 and staff’s draft amendments to Regulation 1655, provided the discussion paper and its draft amendments to Regulation 1655 to the interested parties, and conducted an interested parties meeting on August 8, 2013, to discuss the draft amendments to Regulation 1655. During the interested parties meeting, a participant inquired as to how the provisions of Regulation 1655 would apply to a transaction in which a lessor paid tax at the time the lessor purchased a vehicle which the lessor would then lease. Staff considered the scenario and, subsequent to the meeting, staff explained to the participant that in the event a lessor purchases a vehicle in this state tax paid, the transaction would generally be subject to sales tax and the dealer would likely collect sales tax reimbursement from the lessor. (See Reg. 1660, subd. (c)(2) and (3), regarding property purchased tax-paid and leased in substantially the same form as acquired.) And, staff explained that, with respect to sales tax transactions, the existing provisions of Regulation 1655 would apply to a manufacturer’s claim for a refund for sales tax reimbursement the manufacturer included in restitution paid to a lessor, under the Lemon Law. Furthermore, staff noted that AB 242 did not change the application of the Lemon Law to sales

tax transactions, and that questions regarding the application of Regulation 1655 to sales tax transactions were beyond the scope of the current interested parties process, which was to discuss the issue of whether to amend Regulation 1655 to clarify the new provisions of the Lemon Law applicable to use tax transactions.

Since BTC staff did not receive any other inquiries or comments regarding the draft amendments during or subsequent to the first interested parties meeting and staff had no changes to its recommendation to amend Regulation 1655, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff's draft amendments. Staff also notified interested parties that comments could be submitted up to October 17, 2013, for consideration in the preparation of a Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

#### *December 17, 2013 BTC Meeting*

Subsequently, staff prepared Formal Issue Paper 13-012 and distributed it to the Board Members for consideration at the Board's December 17, 2013, BTC meeting. Formal Issue Paper 13-012 recommended that the Board approve and authorize publication of the amendments to Regulation 1655 (discussed above) in order to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle (as provided in Civ. Code, § 1793.2, subd. (d)(2)(D), as added by AB 242).
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund (consistent with Civ. Code, § 1793.25, subd. (a), as amended by AB 242).
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee (as provided in Civ. Code, § 1793.25, subd. (e), as added by AB 242).<sup>2</sup>

During the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1655 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1655 are reasonably necessary for the specific purpose of making the regulation consistent with and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242, and addressing the issue (or problem) that Regulation 1655 does not currently indicate that AB 242 made amendments to Civil Code sections 1793.2 and 1793.25.

The Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing

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<sup>2</sup> The formal issue paper also recommended that the Board approve a minor grammatical change capitalizing the first letter in the word "Board" in Regulation 1655, subdivision (b)(2)(B).

additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The adoption of the proposed amendments to Regulation 1655 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1655 or the proposed amendments to Regulation 1655.

#### DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-012, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its December 16, 2013, BTC meeting in deciding to propose the amendments to Regulation 1655 described above.

#### ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1655 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1655 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1655 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

#### INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

Prior to the enactment of AB 242, the Lemon Law expressly provided that a manufacturer was required to make restitution to a buyer in an amount equal to the actual price paid or payable by the buyer, including *sales* tax. The Lemon Law further required the Board to reimburse a manufacturer for an amount equal to the *sales* tax which the manufacturer paid to or for a buyer when providing a replacement vehicle or making restitution. However, the Lemon Law did not expressly address the treatment of *use* tax.

As previously explained in more detail above, AB 242 made specific amendments to Civil Code sections 1793.2 and 1793.25. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle. The amendments also clarify that the Board is required to reimburse a manufacturer of a new motor vehicle for an amount equal to the use tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to California's "Lemon Law." In addition, in order to claim reimbursement for such use tax, the amendments specifically require a manufacturer to provide satisfactory evidence that the buyer paid use tax on the sales price of or the lessee paid use tax on the rentals payable from the lease of the vehicle that the manufacturer replaced or made restitution for. And, the amendments specifically provide that, with regard to leases, the amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee under the Lemon Law.

As previously explained in more detail above, subdivision (b)(2) of Regulation 1655 explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement included in restitution paid to a buyer under the Lemon Law. However, Regulation 1655 does not indicate that AB 242 made amendments to the Lemon Law to clarify that restitution includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution.

Also, as previously explained above, the proposed amendments to Regulation 1655 incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle.
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund.
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee.

As a result, the proposed amendments make Regulation 1655 consistent with the amendments made to the Lemon Law by AB 242, the proposed amendments do not mandate that individuals or businesses do anything that is not already required by the Lemon Law, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action, or that would impact revenue. Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the amendments made to the Lemon Law by AB 242 have had and will have on individuals and businesses. The Board has determined that the proposed amendments to Regulation 1655 are not

a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. And, the Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

In addition, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1655 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1655 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1655 will not affect the benefits of Regulation 1655 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1655 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1655 may affect small businesses.

**Text of Proposed Amendments to  
California Code of Regulations, Title 18, Section 1655**

**1655. Returns, Defects and Replacements.**

(a) Returned Merchandise.

(1) In General. Except as provided in paragraph (2) of this subdivision, the amount upon which tax is computed does not include the amount charged for merchandise returned by customers if, (1) the full sale price, including that portion designated as “sales tax,” is refunded either in cash or credit, and (2) the customer, in order to obtain the refund or credit, is not required to purchase other property at a price greater than the amount charged for the property that is returned. Refund or credit of the entire amount is deemed to be given when the purchase price, less rehandling and restocking costs, is refunded or credited to the customer. The amount withheld for rehandling and restocking may not exceed the actual cost of rehandling and restocking the returned merchandise. However, in lieu of using the actual cost for each transaction, the amount withheld for rehandling and restocking may be a percentage of the sales price determined by the average cost of rehandling and restocking returned merchandise during the previous accounting cycle (generally one year). If the seller elects to withhold rehandling and restocking amounts based on a percentage of sales price, the seller is bound by that election for the entire accounting cycle for which the election is made and must apply that percentage in lieu of actual cost during that period on all returned merchandise transactions for which rehandling and restocking costs are withheld. The amount withheld as rehandling and restocking costs may not include compensation for increased overhead costs because of the return, for refinishing or restoring the property to salable condition where the necessity therefore is occasioned by customer usage, or for any expense prior to the “sale” (i.e., transfer of title, lease, or possession under a conditional sale contract). Sellers must maintain adequate records which may be verified by audit, documenting the percentage used.

(2) Contract Cancellation Options Required by Car Buyer’s Bill of Rights.

(A) Contract Cancellation Option. On and after July 1, 2006, the terms “gross receipts” and “sales price” do not include the purchase price for a contract cancellation option agreement with respect to a contract to purchase a used vehicle with a purchase price of less than forty thousand dollars (\$40,000), which a dealer is required to offer to a buyer pursuant to Vehicle Code section 11713.21. The purchase price for a contract cancellation option described in this subparagraph shall not exceed:

1. Seventy-five dollars (\$75) for a vehicle with a cash price of five thousand dollars (\$5,000) or less;
2. One hundred fifty dollars (\$150) for a vehicle with a cash price of more than five thousand dollars (\$5,000), but not more than ten thousand dollars (\$10,000);
3. Two hundred fifty dollars (\$250) for a vehicle with a cash price of more than ten thousand dollars (\$10,000), but not more than thirty thousand dollars (\$30,000); or

4. One percent of the purchase price for a vehicle with a cash price of more than thirty thousand dollars (\$30,000), but less than forty thousand dollars (\$40,000).

(B) Restocking Fee. On and after July 1, 2006, the terms “gross receipts” and “sales price” do not include the dollar amount of a restocking fee the buyer must pay to the dealer to exercise the right to cancel a purchase of a used car under a contract cancellation option agreement pursuant to Vehicle Code section 11713.21 as described in subparagraph (A) of this paragraph. The dollar amount of a restocking fee described in this subparagraph shall not exceed:

1. One hundred seventy-five dollars (\$175) if the vehicle’s cash price is five thousand dollars (\$5,000) or less;
2. Three hundred fifty dollars (\$350) if the vehicle’s cash price is more than five thousand dollars (\$5,000), but less than ten thousand dollars (\$10,000); or
3. Five hundred dollars (\$500) if the vehicle’s cash price is ten thousand dollars (\$10,000) or more.

(C) Amounts Refunded to Customers. On and after July 1, 2006, the terms “gross receipts” and “sales price” do not include that portion of the selling price for a used motor vehicle that is refunded to the buyer due to the buyer’s exercise of the right to return the vehicle for a refund, which is contained in a contract cancellation option agreement pursuant to Vehicle Code section 11713.21 as described in subparagraph (A) of this paragraph.

(b) Defective Merchandise.

(1) In General. Amounts credited or refunded by sellers to consumers on account of defects in merchandise sold may be excluded from the amount on which tax is computed. If, however, defective merchandise is accepted as part payment for other merchandise and an additional allowance or credit is given on account of its defective condition, only the amount allowed or credited on account of defects may be excluded from taxable gross receipts. The amount allowed as the “trade-in” value must be included in the measure of tax.

(2) Restitution or Replacement Under California Lemon Law.

(A) General. Under subdivision (d) of Civil Code section 1793.2, if a manufacturer is unable to service or repair a “new motor vehicle,” as that term is defined in subdivision (e)(2) of Civil Code section 1793.22, to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer must either replace the motor vehicle or provide the buyer restitution of the purchase price, less specified amounts, at the buyer’s election.

For purposes of this regulation, the term buyer shall include a lessee of a new motor vehicle.

(B) Restitution. A manufacturer who pays a buyer restitution pursuant to, and in complete compliance with, subdivision (d)(2) of Civil Code section 1793.2 is entitled to a refund of the amount of sales or use tax, or sales tax reimbursement included in the restitution paid by the manufacturer to the buyer. The manufacturer may file a claim for refund of that amount with the Board. The claim must include a statement that the claim is submitted in accordance with the provisions of section 1793.25 of the Civil Code. The manufacturer must submit with the claim documents evidencing that restitution was made pursuant to, and in complete compliance with, subdivision (d)(2) of Civil Code section 1793.2 including: a copy of the original sales or lease agreement between the buyer and the dealer or lessor of the non-conforming motor vehicle; copies of documents showing all deductions made in calculating the amount of restitution paid to the buyer along with full explanations for those deductions, including settlement documents and odometer statements; a copy of the title branded “Lemon Law Buyback” for the non-conforming motor vehicle returned by the buyer; and proof that the decal the manufacturer is required to affix to that motor vehicle has been so affixed in accordance with section 11713.12 of the Vehicle Code. The manufacturer must also submit with the claim the seller’s permit number of the dealer or lessor who made the retail sale or lease of the non-conforming motor vehicle to the buyer, and evidence for one of the following:

1. that the dealer had reported and paid sales tax on the gross receipts from that sale; or
2. The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state; or
3. The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of the vehicle.

For purposes of this regulation, the number of attempts made to repair the non-conforming motor vehicle, if any, prior to providing the customer restitution is not relevant for purposes of determining whether restitution has been made pursuant to subdivision (d)(2) of Civil Code section 1793.2.

(C) Replacement. For purposes of this regulation, a manufacturer who, pursuant to subdivision (d)(2) of Civil Code section 1793.2, replaces a non-conforming motor vehicle with a new motor vehicle substantially identical to the motor vehicle replaced is replacing the motor vehicle under the terms of the mandatory warranty. No additional tax is due unless the buyer is required to pay an additional amount to receive the replacement motor vehicle, in which case tax is due measured by the amount of that payment. If an amount is refunded to the customer as part of the exchange of the non-conforming motor vehicle for the replacement motor vehicle, then that amount is regarded as restitution for purposes of this regulation if it satisfies the requirements of subdivision (d)(2) of Civil Code section 1793.2. The manufacturer may file a claim for refund under subdivision (b)(2)(B) of this regulation for the amount of sales or use tax, or sales tax reimbursement that is included in the amount of that restitution paid by the manufacturer to the buyer.

For purposes of this regulation, the number of attempts made to repair the non-conforming motor vehicle, if any, prior to providing the customer a replacement is not relevant for purposes of determining whether the replacement has been made pursuant to subdivision (d)(2) of Civil Code section 1793.2.

(D) The amount of use tax the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee pursuant to Civil Code section 1793.2.

(c) Replacement Parts -Warranties.

(1) In General -Definitions. "Mandatory Warranty." A warranty is mandatory within the meaning of this regulation when the buyer, as a condition of the sale, is required to purchase the warranty or guaranty contract from the seller. "Optional Warranty." A warranty is optional within the meaning of this regulation when the buyer is not required to purchase the warranty or guaranty contract from the seller, i.e., the buyer is free to contract with anyone he or she chooses.

(2) Mandatory Warranties. The sale of tangible personal property includes the furnishing, pursuant to the guaranty provisions of the contract of sale, or mandatory warranty, of replacement parts or materials, and if the property subject to the warranty is sold at retail, the measure of the tax includes any amount charged for the guaranty or warranty, whether or not separately stated. The sale of the replacement parts and materials to the seller furnishing them thereunder is a sale for resale and not taxable.

(3) Optional Warranties. The person obligated under an optional warranty contract to furnish parts, materials, and labor necessary to maintain the property is the consumer of the materials and parts furnished and tax applies to the sale of such items to that person. If he or she purchased the property for resale or from outside California, without tax paid on the purchase price, he or she must report and pay tax upon the cost of such property to him or her when he or she appropriates it to the fulfillment of the contract of warranty.

(4) Deductibles. A deductible paid by a customer under the terms of a mandatory or optional warranty contract is subject to tax measured by the amount of the deductible allocable to the sale of tangible personal property to the customer. For example, if the itemized sales price of tangible personal property (or the fair retail value if not separately itemized) provided pursuant to a warranty is 50 percent of the total fair retail value of the repairs and the deductible is \$100, 50 percent of that deductible, \$50, would be allocable to the sale of tangible personal property and would be subject to tax, whether the warranty were optional or mandatory. Unless otherwise stated in the warranty contract, when either an optional or a mandatory warranty provides that the customer will pay a deductible towards repairs and services provided under the warranty, the person providing the warranty contract is liable for any tax or tax reimbursement otherwise payable by the customer with respect to that deductible.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006-6012 and 6012.3, Revenue and Taxation Code; Sections 1793.2-1793.25, Civil Code; and Sections 11713.12 and 11713.21, Vehicle Code.

## Regulation History

**Type of Regulation:** Sales and Use Tax

Regulation: 1655

Title: 1655, *Returns, Defects and Replacements*

**Preparation:** Monica Silva

**Legal Contact:** Monica Silva

The proposed amendments to Regulation 1655, *Returns, Defects and Replacements*, clarify that the regulation's provisions regarding restitution and replacement under the "Lemon Law" apply to use tax under specified circumstances.

### History of Proposed Regulation:

April 22-24, 2014	Public Hearing
February 14, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
February 4, 2014	Notice to OAL
December 17, 2013	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor: NA

Support: NA

Oppose: NA