

M e m o r a n d u m

To : Mr. Ramon J. Hirsig
Executive Director, MIC:73

Date: November 2, 2006

From : Kristine Cazadd, Chief Counsel
Legal Department, MIC:83 

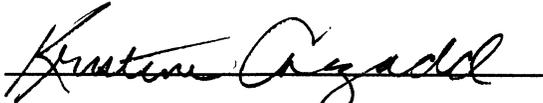
Subject : Regulation 1566, *Automobile Dealers and Sales Representatives*
and Regulation 1655, *Returns, Defects and Replacements*
Chief Counsel's Rulemaking Calendar
Board Meeting—November 20, 2006

Assembly Bill (AB) 68 (Ch. 128, Statutes of 2005), operative July 1, 2006, enacted the Car Buyer's Bill of Rights. Among other effects, this bill requires car dealers to offer a two-day contract cancellation option for used vehicles under \$40,000. In order to incorporate new statutory provisions, we request your approval to place proposed amendments to Regulations 1566 and 1655 on the Chief Counsel's Rulemaking Calendar on November 20, 2006. These changes are appropriate to process under Rule 100, without the normal notice and hearing process, because the proposed amendments would make the regulations consistent with a statutory change.

For sales and use tax purposes, the relevant statutes added by AB 68 are Vehicle Code (VC) section 11713.21 and Revenue and Taxation Code (RTC) section 6012.3. In providing the requirements for the contract cancellation option, VC section 11713.21 limits amounts that dealers may charge for both the contract cancellation option and the restocking fee for a returned vehicle to a sliding scale based on the price for the vehicle. AB 2303 (Ch. 567, Statutes of 2006) corrected a minor ambiguity in VC 11713.21 regarding the requirement to offer a contract cancellation option if a used vehicle is sold for \$40,000 exactly. New RTC section 6012.3 specifies that neither the charge for the contract cancellation option nor the portion of the sales price returned to the purchaser under the contract cancellation option is part of taxable gross receipts.

The ~~strikeout~~ and underlined versions of the regulations are attached. If you have any questions regarding this request, please let me know or contact Ms. Lisa Andrews at 322-5989.

Recommendation by:



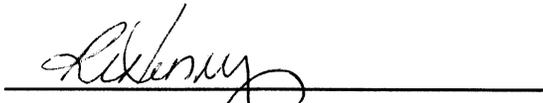
Kristine Cazadd, Chief Counsel

Approved:



Ramon J. Hirsig, Executive Director

Approved:



Randie L. Henry, Deputy Director
Sales and Use Tax Department

BOARD APPROVED

At the _____ Board Meeting



Gary Evans, Acting Chief
Board Proceedings Division

Attachment

cc (all with attachment):
Ms. Randie L. Henry (MIC 43)
Mr. Gary Evans (MIC 80)
Mr. Robert Lambert(MIC 82)
Mr. Randy Ferris (MIC 82)
Mr. Charles Daly (MIC 85)
Mr. Jeffrey L. McGuire (MIC 92)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lisa Andrews (MIC 50)

Regulation 1566. AUTOMOBILE DEALERS AND SALES REPRESENTATIVES

Reference: Revenue and Taxation Code sections 6011, 6012, 6012.3, 6015, 6092-6242, 6248, 6249, 6271-6294, and 6422.1; and Chapter 3.5 (commencing with Section 6271), Revenue and Taxation Code and Vehicle Code section 11713.21.

(a) DEALER AID TO SALES REPRESENTATIVES. An automobile dealer, pursuant to section 6015, is regarded as the retailer of tangible personal property sold by the dealer's sales representatives in their own behalf if the dealer aids the sales representatives in making such sales in either of the following ways:

- (1) By reporting the sales representatives' sales on the dealer's report of sales to the Department of Motor Vehicles.
- (2) By executing conditional sales agreements with respect to such sales representatives' sales in which the dealer appears as the seller.

Dealers who aid their sales representatives by acting as guarantors on conditional sales agreements executed by the sales representatives or by requiring or permitting the sales representatives to use the dealer's showroom or other facilities in making such sales are not required to pay tax on the sale of the vehicles. The purchasers from these sales representatives, and from sales representatives making sales without dealer aid, must pay the use tax to the Department of Motor Vehicles.

(b) RESALE CERTIFICATES FROM NONDEALER RETAILERS. A dealer who is licensed or certificated pursuant to the California Vehicle Code and who sells a vehicle to a retailer who is not regularly engaged in selling or leasing vehicles should accept a resale certificate only if it contains a statement that the specific vehicle is being purchased for resale in the regular course of business.

Unless the person named as the purchaser on the resale certificate is also named on the dealer's report of sale and application for registration, either singly or jointly as registered owner, the sale will be regarded as a retail sale subject to sales tax, and the resale certificate will not be honored, whether or not it contains a statement that the specific vehicle is being purchased for resale in the regular course of business.

(c) SALES TO MEMBERS OF THE ARMED SERVICES. A dealer (or manufacturer or dismantler) who is licensed or certificated pursuant to the California Vehicle Code must report and pay sales tax to the Board with respect to the sale of a vehicle in California to a member of the armed services regardless of the service member's place of residence. A dealer (or manufacturer or dismantler) so licensed or certificated who sells a vehicle outside of California to a member of the armed services for use in California must collect use tax from the service member and remit it to the Board unless the sale is made to a service member on active duty, prior to the effective date of discharge and the intention to use the vehicle in California results from official transfer orders to California and not from the service member's own independent determination. The service member will be considered to have made an independent determination to use the vehicle in California if the contract to purchase the vehicle is made after the service member receives official transfer orders to California or if at the time the contract to purchase the vehicle is made the service member arranges to take receipt of the vehicle in California.

(d) OUT-OF-STATE PURCHASES OF VEHICLES. Regarding the applicability of tax to the out-of-state purchase of a vehicle, see subdivision (b) of Regulation 1620 (18 CCR 1620).

(e) CONTRACT CANCELLATION OPTIONS REQUIRED BY CAR BUYER'S BILL OF RIGHTS.

(1) 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 paragraph shall not exceed:

(A) Seventy-five dollars (\$75) for a vehicle with a cash price of five thousand dollars (\$5,000) or less;

(B) 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);

(C) 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

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Regulation 1566 (Continued)

(D) 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).

(2) 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 described in paragraph (1) of this subdivision. The dollar amount of a restocking fee described in this paragraph shall not exceed:

(A) One hundred seventy-five dollars (\$175) if the vehicle's cash price is five thousand dollars (\$5,000) or less;

(B) 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

(C) Five hundred dollars (\$500) if the vehicle's cash price is ten thousand dollars (\$10,000) or more.

(3) 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 described in paragraph (1) of this subdivision.

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Regulation 1655. RETURNS, DEFECTS AND REPLACEMENTS

References: Revenue and Taxation Code Sections 6006-6012, and 6012.3, Revenue and Taxation Code; Civil Code Sections 1793.2-1793.25, Civil Code; and Vehicle Code Sections 11713.12 and 11713.21, Vehicle Code.
 Barter, Exchange, Trade-Ins, see Regulation 1654.
 Auction Sales, agreement not to deliver property or to return amount paid, see Regulation 1565

(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 therefor 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 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.

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(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 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.

(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 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 agreement between the buyer and the dealer 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 who made the retail sale of the non-conforming motor vehicle to the buyer, and evidence that the dealer had reported and paid sales tax on the gross receipts from that sale. 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 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.

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(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.

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