California State
Board *of* Equalization

Legislative Enrolled Bill Analysis

Legislative and Research Division

Assembly Bill 2365 (Gipson, et al.)
Program: Sales and Use Tax
Sponsor: Board of Equalization
Revenue and Taxation Code Section 6010.15
Effective: Upon enactment

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Summary: Until January 1, 2022, excludes from the computation of sales or use tax, a pawnbroker's receipts derived from a transaction where customers buy back their property after defaulting on a loan.

Purpose: Resolves a confusing area in the law and eliminates a public policy counterproductive to customers regaining ownership of their property.

Fiscal Impact Summary: Annual state and local revenue loss of $33,250.

Existing Law: Existing law[1] imposes the sales tax on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use or other consumption in this state of tangible personal property purchased from a retailer.[2] The sales tax is measured by gross receipts from retail sales. The use tax is measured by the sales price of the property. Under the law, "sales price" and "gross receipts," respectively, are defined to include the total amount of the sale, lease or rental price, whether received in money or otherwise. The total amount of the sale, lease or rental price includes all of the following:

- Any services that are a part of the sale
- All receipts, cash, credits and property of any kind
- Any amount for which credit is allowed by the seller to the purchaser

Pawnbrokers are considered retailers under the Sales and Use Tax Law, as they are in the business of making retail sales of tangible personal property. Tax applies to sales by pawnbrokers to the same extent as sales by any other retailer of tangible personal property in this state.

Collateral Loans. California's Department of Justice regulates pawnbrokers and enforces California's Financial Code relative to pawnbrokers.[3] Pawnbrokers lend money to the person that pledged the property ("customer") on items of collateral, including gold and diamond jewelry, musical instruments, televisions, electronics, tools, household items, and firearms, among other things. Pawnbrokers base their loans on the collateral's value, and hold the collateral until the customer's loan and related charges and interest have been repaid.

When a customer pays back the loan, the pawnbroker returns the merchandise (the collateral) to the customer. If the customer has not repaid the loan by the end of the loan period, the pawnbroker is required to send a 10-day reminder notice to the customer. The customer can either (1) retrieve the collateral by paying all charges due, (2) renew the contract by paying all charges by the date on the notice, or (3) default on the loan. If a customer defaults, the collateral becomes the pawnbroker's property ("vested property").

After title has vested with the pawnbroker, the customer no longer has any legal right to the property that would distinguish him or her from any other customer. Accordingly, when a customer subsequently retrieves the collateral from the pawnbroker for consideration, and the pawnbroker transfers the property back to the customer, that transaction constitutes a retail sale under the Sales and Use Tax Law. Consequently, tax applies to the consideration provided to the pawnbroker for that transfer (unless the sale is otherwise exempt or excluded from the sales or use tax).

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[1] Part 1, Division 2, Chapter 2 (commencing with Section 6051) of the Revenue and Taxation Code (RTC).
[2] Part 1, Division 2, Chapter 3 (commencing with Section 6201) of the RTC.
[3] Division 8 (Sections 21000-21037) of the Financial Code.

Proposed Law: Until January 1, 2022, this bill excludes from the definition of "sale" and "purchase," the transfer of tangible personal property by a pawnbroker, as defined, to a person that pledged the property under the following specified conditions:

- The transfer occurs no more than six months after the pawnbroker obtained title to the vested property, as defined.
- The person is not required to pay the pawnbroker any amount in excess of the unpaid loan balance and allowable charges and interest as set forth in the Financial Code, as specified.

Commentary:

1. **Effect of the bill.** Excludes from the computation of sales or use tax, a pawnbroker's receipts derived from a transaction where customers buy back their property after defaulting on a loan.
2. **The May 16, 2016 amendments** added a 5-year sunset date of January 1, 2022.
3. **This bill simplifies a confusing area in the law.** This bill would eliminate a complexity in the law that can potentially subject unaware pawnbrokers to liability for the tax.
4. **The sales tax comes as a surprise to customers.** Customers are often surprised that they must pay sales tax on their own item's reacquisition, and the additional sales tax sometimes serves as an impediment to regaining ownership. This bill would eliminate this problem as long as the customer reacquires the item within six months of title transferring to the pawnbroker.
5. **The tax is counterproductive.** Imposing the tax when customers return to buy back their property is counterproductive to the public policy of allowing customers to regain their property's ownership.

Costs: BOE will incur absorbable administrative costs to notify affected pawnbrokers, audit claimed exemptions, amend appropriate regulations, and answer inquiries from the general public.

Revenue Impact: Industry sources indicate that the national average pawn loan amount is $150 and that 85% of pawn customers repay their loans and redeem their collateral within the contract period. An estimated 30 million U.S. consumers use licensed pawnbroker services.

Staff estimates that about 3.6 million Californians (12% × 30 million) use pawn store services, and that, of the 15% that fail to timely repay their loans, less than one-half percent purchase their item after the pawnbroker has vested title (3.6 million x 15% x 0.5%) or 2,700 customers. Therefore, this bill would exclude from tax sales of approximately $405,000 (2,700 x $150) annually. Accordingly, the estimated annual state and local revenue loss amounts to $33,250 ($405,000 x 8.21% average rate).