

Amend Revenue and Taxation Code Section 6248 of the Sales and Use Tax Law to clarify the definition of “California resident” and the exception for repair, retrofit, and modification for purposes of the 12-month test for out-of-state purchases of a vehicles, vessels and aircraft.

Source: Sales and Use Tax Department

Existing Law

The approval of the 2008-2009 California Budget included the enactment of AB 1452 (Stats 2008, Chapter 763, effective September 30, 2008), which in part amended Revenue and Taxation Code Section 6248. The amendments permanently replaced the “90-day test” with a “12-month test” for determining whether an out-of-state purchase of a vehicle, vessel, or aircraft was for the purpose of storage, use, or other consumption in California and subject to California use tax. This “12-month test” was also operative during the period from October 2, 2004, through June 30, 2007.

This 12-month test essentially provides that within 12 months from the date of purchase, a vehicle, vessel or aircraft purchased outside this state is *presumed* to be acquired for storage, use, or other consumption in California and subject to tax if any of the following occurred:

1. The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the California Vehicle Code, or
2. In the case of a vehicle, the vehicle was subject to vehicle registration in California during the first twelve months of ownership, or
3. In the case of an aircraft or vessel, the aircraft or vessel was subject to property tax in California during the first twelve months of ownership, or
4. If purchased by an out-of-state resident, the vehicle, vessel, or aircraft is used or stored in this state more than one-half of the time during the first 12 months of ownership.

Under these provisions, however, the law provides that an aircraft or vessel will not be deemed to have been purchased for use in this state if that aircraft or vessel was brought into this state during the first 12 months of ownership for the purpose of repair, retrofit, or modification of the aircraft or vessel, provided that no more than 25 hours of airtime or sailing time were logged for that purpose, as specified. Additionally, the law provides that a vehicle brought into this state within the first 12 months of ownership for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less, as specified, would also not be deemed to be purchased for use in this state.

This Proposal

This proposal would close two loopholes that surfaced when the Board administered the 12-month test provisions in 2004 through 2007, and that Board staff anticipates will resurface now that the 12-month test provisions have been made permanent.

Limited Liability Companies. With respect to the first loophole, under the 12-month test language, out-of-state residents are required to show only that the vehicle, vessel

or aircraft was outside California more than six months during the first 12 months of ownership. This encouraged many California purchasers to set up shell corporations and limited liability companies in other states so that they would not be considered California residents, and would only be subjected to the six-month test, rather than the 12 month test that is applied to California residents. Therefore, this proposal would clarify that a California resident shall include corporations and limited liability companies when 50% or more of their membership interests is held by shareholders or members who are California residents.

These new schemes for avoiding tax on purchases of recreational vehicles were highlighted in an article in a September 25, 2006, issue of the Los Angeles Times, "Under A Big Sky, They Turn RVs Into Dodges." This article reported, "Montana has no sales tax, and recreational-vehicle aficionados are taking a break from their road maps and AAA Trip-Tiks to set up shell corporations in the state...Most states make it difficult for nonresidents to get license plates. But Montana lets out-of-staters register vehicles if they own a local limited liability corporation. Setting one up merely requires some simple paperwork and about \$1300 to cover incorporation costs, registration fees and attorney hours."

By setting up a limited liability company in Montana to own an RV, California residents could not only take advantage of Montana's lower vehicle registration fees, but when they brought their RV's into California, they believed that their purchases were not subject to the same presumptions regarding whether or not the vehicles were purchased for use in California as vehicle purchases by other California residents.

The staff received information that showed that approximately 900 vehicles were registered in Montana by Montana limited liability companies that appear to be closely held by California residents. Estimated taxable measure for these 900 vehicles is \$227 million with tax of \$16.5 million. The Los Angeles Times article, *Under a Big Sky...*, reported that based on comparisons of Montana vehicle records with California addresses, officials at the California Attorney General's office indicated that they believe as many as 10,000 Californians have put Montana plates on their motor homes in recent years, costing the State over \$160 million for "this particular type of fraud."

For vessel purchases, it appears that many California residents are establishing limited liability companies or corporations in Oregon to show an Oregon address for their vessels. The Board's Consumer Use Tax Section has identified a recurring Oregon address for the agent of record claiming exemption for transfers of vessels to a commencing corporation. As of October, 2008, the Oregon Secretary of State's database indicated that 2,103 transfers were registered in Oregon by this agent. Of those, 1,478 have been identified as limited liability companies connected to California through the address identified as the principal place of business, the mailing address, or the address for the members.

Repairs. With regard to the second loophole, the law makes an exception for repair, retrofit, and modification so that if a California resident brings a vehicle, vessel or aircraft into California during the 12-month test period solely for those services, the 12-month out-of-state usage requirement to avoid the tax wouldn't be violated. This

proposal would clarify that repair, retrofit and modification must be performed by a licensed repair facility in order to qualify for the exception.

The repair, retrofit and modification exception was included in law so that California businesses that service vehicles, vessels and aircraft would not be harmed economically. The abuses of this exception with aircraft were minor since the FAA requires that aircraft maintenance and modification be performed or inspected by an FAA certified repair facility. However, this exception was widely abused by vessel owners. Many vessel owners were constantly changing or repairing items on their vessels, and many vessels in California were used regularly without leaving their moorage. Board staff has had many cases in which a taxpayer regularly purchased minor parts or accessories for self-performed repair or modification over an extended period of time without ever sailing the vessel, and while keeping and using the vessel in California for purposes other than sailing. In one case, a taxpayer even lived on board the vessel while self-performing repairs and modification, but asserted that since the vessel was not sailed for more than 25 hours, the vessel was not taxable under the law.

These proposed changes preserve the legislative desire to minimize the impact of the 12-month test on California businesses in the industry, while clarifying that the exception was not provided as a method of tax avoidance. It should be noted that similar amendments to close these loopholes were adopted by the Board at its November 14, 2007 Legislative Committee meeting. However, the Governor's office, which supported the reinstatement of the 12-month test, was not willing to make changes to the language as the budget negotiations were occurring.

Section 6248 of the Revenue and Taxation Code is amended to read:

6248. (a) ~~(a) On and after the effective date of this section, there~~ There shall be a rebuttable presumption that any vehicle, vessel, or aircraft bought outside of this state on or after the effective date of this section, and which is brought into California within 12 months from the date of its purchase, was acquired for storage, use, or other consumption in this state and is subject to use tax if any of the following occurs:

(1) The vehicle, vessel, or aircraft was purchased by a California resident as defined in Section 516 of the Vehicle Code. For purposes of this section, closely-held corporations or limited liability corporations shall also be considered California residents if 50 percent or more of the shares or membership interests are held by shareholders or members who are residents of California as defined in Section 516 of the Vehicle Code.

(2) In the case of a vehicle, the vehicle was subject to registration under Chapter 1 (commencing with Section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership.

(3) In the case of a vessel or aircraft, that vessel or aircraft was subject to property tax in this state during the first 12 months of ownership.

(4) If purchased by a nonresident of California, the ~~The~~ vehicle, vessel, or aircraft is used or stored in this state more than one-half of the time during the first 12 months of ownership.

(b) This presumption may be controverted by documentary evidence that the vehicle, vessel, or aircraft was purchased for use outside of this state during the first 12 months of ownership. This evidence may include, but is not limited to, evidence of registration of that vehicle, vessel, or aircraft, with the proper authority, outside of this state.

(c) This section shall not apply to any vehicle, vessel, or aircraft used in interstate or foreign commerce pursuant to regulations prescribed by the board.

(d) The amendments made to this section by the act adding this subdivision shall not apply to any vehicle, vessel, or aircraft that is either purchased, or is the subject of a binding purchase contract that is entered into, on or before the operative date of this subdivision.

(e) (1) Notwithstanding subdivision (a), any aircraft or vessel brought into this state exclusively for the purpose of repair, retrofit, or modification shall not be deemed to be acquired for storage, use, or other consumption in this state if the repair, retrofit, or modification is, in the case of a vessel, performed by a repair facility that holds an appropriate permit issued by the board and is licensed to do business by the county in which it is located, or, in the case of an aircraft, performed by a repair station certified by the Federal Aviation Administration or a manufacturer's maintenance facility.

~~—(2) This subdivision shall not apply if, during the period following the time the aircraft or vessel is brought into this state and ending when the repair, retrofit, or modification of the aircraft or vessel is complete, more than 25 hours of airtime in the case of an airplane or 25 hours of sailing time in the case of a vessel is logged on the aircraft or vessel by the registered owner of that aircraft or vessel or by an authorized agent operating the aircraft or vessel on behalf of the registered owner of the aircraft or vessel. The calculation of airtime or sailing time logged on the aircraft or vessel shall not include airtime or sailing time following the completion of the repair, retrofit, or modification of the aircraft or vessel that is logged for the sole purpose of returning or delivering the aircraft or vessel to a point outside of this state.~~

~~—(3) This subdivision shall apply to aircraft or vessels brought into this state for the purpose of repair, retrofit, or modification on or after the operative date of this subdivision.~~

(f) The presumption set forth in subdivision (a) may be controverted by documentary evidence that the vehicle was brought into this state for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less. The 30-day period begins when the vehicle enters this state, includes any time of travel to and from the warranty or repair facility, and ends when the vehicle is returned to a point outside the state. The documentary evidence shall include a work order stating the dates that the vehicle is in the possession of the warranty or repair facility and a statement by the owner of the vehicle specifying dates of travel to and from the warranty or repair facility.