



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/24/10	Bill No:	SBx6 5
Tax:	Sales and Use	Author:	Hollingsworth
Related Bills:	SB 658 (Walters) SB 714 (Dutton)		

BILL SUMMARY

This bill would provide an exclusion from the computation of sales and use tax the value of a vehicle traded in for a new vehicle (including a new motorcycle), if the value of the trade-in vehicle is separately stated on the new vehicle invoice or bill of sale or similar document provided to the purchaser.

ANALYSIS

CURRENT LAW

Existing law imposes a sales or use tax on the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, the sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use or other consumption in this state of tangible personal property purchased from a retailer. The sales tax is measured by gross receipts from retail sales. The use tax is measured by the sales price of the property. Under Revenue and Taxation Code Sections 6011 and 6012, respectively, "sales price" and "gross receipts" are defined to include the total amount of the sale or lease or rental price, whether received in money or otherwise. The total amount of the sale or 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.

The Board's Regulation 1654, *Barter, Exchange, and "Trade-Ins,"* explains the application of tax to sales and purchases involving "trade-ins." Subdivision (b)(1) provides that the value of a trade-in of a used vehicle or any other item of tangible personal property may not be excluded from the computation of sales tax with respect to the property being sold for which the trade-in allowance is given. For example, if a dealer sells a new vehicle for \$20,000 and accepts a trade-in with a value at \$4,000 as partial payment, sales tax is still based on the \$20,000 selling price.

And when merchandise is "traded-in" on the purchase price of other merchandise, the retailer accepting the trade-in must include in the amount subject to tax the amount agreed upon between the retailer and the purchaser as the allowance for the merchandise traded in. This is true even in cases where no further money is required to be paid by the purchaser in the trade. For example, if a person brings a diamond ring to a jeweler and makes an even exchange for a different ring, the jeweler would be required to report sales tax on the fair retail market value of that diamond ring traded in.

PROPOSED LAW

This bill would amend Sections 6011 and 6012 of the Sales and Use Tax Law to provide that the definitions for “sales price” and “gross receipts” do not include the value of a vehicle traded-in for a new vehicle, including a new motorcycle, when the value of the trade-in vehicle is separately stated on the new vehicle invoice or bill of sale or similar document provided to the purchaser.

This bill would become operative on the first day of the first calendar quarter commencing more 90 days after the bill is enacted.

BACKGROUND

Last year, two similar bills were introduced: SB 658 (Walters, et al.) and SB 714 (Dutton), and in 2007-08, another similar measure was considered - SB 1417 (Hollingsworth). All three bills were held in the Senate Revenue and Taxation Committee.

Two similar measures also were considered during the 1997-98 Legislative Session. AB 1340 (Prenter & Bowler), which died on the Assembly Appropriations suspense file, and AB 1691 (Prenter), which failed passage in Assembly Revenue and Taxation Committee.

COMMENTS

1. **Sponsor and purpose.** This bill sponsored by the author, who notes that, “Many states provide trade-in exceptions from state sales tax and providing for this exemption, these states have created a more equitable tax structure for consumers. Currently, California taxpayers are expected to pay sales tax on the full price of a new vehicle purchase, even when they are providing a trade-in vehicle in lieu of a total cash payment. The state’s sales tax was never designed to place a tax burden on the exchange of goods between individuals and businesses.”

In addition, the author intends his bill to encourage more consumers to “purchase newer vehicles which, on average, are safer and cleaner than older models.”

2. **“Vehicle” should be defined.** There are varying definitions both in the Sales and Use Tax Law and the Vehicle Code for the term “vehicle” and “motor vehicle.” The Sales and Use Tax Law defines the term “vehicle” and “motor vehicle” under Revenue and Taxation Code Section 6022 by reference to Vehicle Code Sections 415 and 670. Section 6272 of the Sales and Use Tax Law defines the term “vehicle” by reference to Vehicle Code Section 670, and further defines “vehicle” to include off-highway motor vehicles subject to identification under Division 16.5.

Vehicle Code Section 670 states that a vehicle is a device by which any person or property may be propelled, moved, or drawn upon a highway, except rail cars or human-powered vehicles. Division 16.5 of the same states that “vehicle” includes various off-highway vehicles, i.e., race cars, snow mobiles, all-terrain vehicles, amphibious vehicles, go carts, and even golf carts.

In addition, Vehicle Code Section 415 defines “motor vehicle” to include any vehicle which is self-propelled. This term can, therefore, include such items as bulldozers, tractors, buses, and recreational vehicles in addition to the vehicles noted under Section 670 and Division 16.5. Consequently, in order for the Board to properly administer the proposed exclusion consistent with the author’s intent, it is recommended that the bill define the term “vehicle.” Without a definition, the bill

could be interpreted more broadly than intended, resulting in an even greater revenue loss than anticipated.

3. **What would be considered a “new” vehicle?** Vehicle dealers routinely make temporary uses of vehicles before reselling them. For example, certain vehicles may be occasionally removed from resale inventory for temporary use as a company or service vehicle (e.g., vehicle used by administrative department or used by the parts and service department). Other temporary uses include loans to a customer who is waiting for another vehicle that is being repaired or to a customer who is waiting for delivery of a vehicle they have purchased. In general, when a dealer temporarily removes a vehicle from its resale inventory for use as a company or service vehicle or loaned to customers, they are required to report use tax based on the vehicle’s fair rental value for the period of such use.

Even though a vehicle may be used on a temporary basis, would the vehicle qualify as “new” for purposes of the proposed trade-in exemption? Board staff will work with the author’s office as the bill progresses to address this concern.

4. **The bill would not apply to other items commonly traded in.** While the bill limits the proposed exclusion to trade-ins of vehicles for new vehicles, which is probably one of the most common areas in which trade-ins are involved, there is certainly other merchandise in which purchasers receive credit for their trade-ins. Jewelry, washing machines and dryers, trading cards, tires, car batteries, etc., are just a few examples.
5. **Enactment of this measure would not complicate the Board’s administration, if the bill is amended to define “new” and “vehicle.”** From a tax administrative standpoint, if the bill is amended to clearly define a new vehicle, its enactment would not materially affect the Board’s current auditing practices of car dealers. Currently, trade-in values are already closely examined in audits of car dealers, since consistent trade-in under-allowances may be an indication that a dealer is attempting to reduce the selling price of the vehicle being sold in an effort to reduce his or her tax liability. For example, assume a 2003 mint condition Jaguar is being traded in for a 2010 Jaguar. In order to make a sale, a dealer may under-value the 2003 Jaguar, so that he or she could lower the sales price of the new Jaguar. Although the dealer’s profit margin would be the same, the sales tax base would be reduced, since the tax would be computed on a lower base.

COST ESTIMATE

Some administrative costs would be incurred in notifying car dealers, revising the Board’s regulation and publications, and answering inquiries from taxpayers. An estimate of these costs is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

According to information published by the National Automobile Dealers Association (NADA) new car dealers sold at their dealerships 11.4 million used cars in 2007. However; according to information from the Department of Finance, new car sales registration in California have dropped by 39.5% since 2007, which reduces the cars sold to 6.9 million. Of these 6.9 million used cars, 53 percent or 3.66 million were obtained as trade-ins on new car purchases. California represents 11.7 percent of the new car registrations nationwide. If we apply the 11.7 percent to the 3.66 million used

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cars obtained as trade-ins, then California dealers sold 428,000 used cars at their dealerships that they obtained as trade-ins on new car purchases. The average selling price for these used cars was \$15,715. New car dealers normally allow the new car purchaser the wholesale value of the used car being traded in. The wholesale value is estimated to be about 62 percent of the retail selling price of the used car. The average trade-in value would be 62 percent of \$15,715 or \$9,743. Total trade-in value for the estimated 428,000 used cars sold at retail by new car dealers would be \$4.17 billion.

New car dealers also sold at wholesale 7.1 million used cars in 2007; however we estimate a 39.5% reduction since 2007, which reduces the cars sold to 4.3 million. These are the cars that they did not keep and sell at retail, but sold to used car dealers or other retailers. If we assume that 53 percent of these used cars were obtained as trade-ins on new car purchases, then 2.3 million of these used cars were obtained from that source. Assuming that California new car dealers accounted for 11.7 percent of these used cars, then California would account for 266,000 of these used cars. The used cars that new car dealers sell at wholesale are assumed to be older and less expensive than the ones that the new car dealers keep to sell at retail. If we assume that the average trade-in value on these cars is half of the trade-in value for those that the dealers keep, then the average trade-in value for these used cars would be \$4,746. The total trade-in value for these used cars would be \$1.26 billion.

The total value of trade-ins of used cars by purchasers of new cars in California is estimated to be \$5.43 billion for the year 2010. (\$4.17 billion + \$1.26 billion = \$5.43 billion.)

REVENUE SUMMARY

The annual revenue loss from excluding from the computation of sales or use tax the estimated \$5.43 billion in trade-in allowances given by a motor vehicle dealer on a used vehicle traded in by a purchaser of a new vehicle would be as follows:

	<u>Revenue Loss</u>
State Loss (6.00%)	\$326 million
Fiscal Recovery Fund (0.25%)	14 million
Local Loss (2.00%)	108 million
District Loss (0.85%)	<u>46 million</u>
Total	<u>\$494 million</u>

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