



STATE BOARD OF EQUALIZATION

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State Controller

CYNTHIA BRIDGES
Executive Director

December 6, 2013

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the December 17, 2013 Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1655, *Returns, Defects and Replacements*, to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by Assembly Bill 242 (Stat. 2011, Ch. 727).

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m. on December 17, 2013** in Room 121 at the address shown above.

Sincerely,

Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB:rsw

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC:71)
Senator George Runner (Ret.), Member, Second District (via email)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. David Hunter, Board Member's Office, Fourth District

Mr. Michael Vigil, Board Member's Office, Fourth District

Mr. Neil Shah, Board Member's Office, Third District

Mr. Tim Treichel, Board Member's Office, Third District

Mr. Alan LoFaso, Board Member's Office, First District

Ms. Mengjun He, Board Member's Office, First District

Ms. Yvette Stowers, Board Member's Office, First District

Mr. Ramon Salazar, Board Member's Office, First District

Mr. Sean Wallentine, Board Member's Office, Second District

Mr. James Kuhl, Board Member's Office, Second District

Mr. Lee Williams, Board Member's Office, Second District

Mr. Alan Giorgi, Board Member's Office, Second District

Ms. Lynne Kinst, Board Member's Office, Second District

Ms. Natasha Ralston Ratcliff, State Controller's Office

Ms. Cynthia Bridges (MIC:73)

Mr. Randy Ferris (MIC:83)

Mr. Jeffrey L. McGuire (MIC:43)

Mr. Robert Tucker (MIC:82)

Mr. Bradley Heller (MIC:82)

Mr. Lawrence Mendel (MIC:82)

Ms. Monica Silva (MIC:82)

Ms. Kirsten Stark (MIC:50)

Mr. Clifford Oakes (MIC:50)

Mr. Bradley Miller (MIC:92)

Ms. Lynn Whitaker (MIC:50)

Mr. Robert Wilke (MIC:50)

AGENDA — December 17, 2013 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1655, Returns, Defects and Replacements

<p>Action 1 – Staff Recommendation</p>	<p><i>(Only the proposed amendments to subdivision (b) of this regulation have been provided. Other subdivisions of the regulation are not being amended.)</i></p> <p>(b) Defective Merchandise.</p> <p>(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.</p> <p>(2) Restitution or Replacement Under California Lemon Law.</p> <p>(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.</p> <p><u>For purposes of this regulation, the term buyer shall include a lessee of a new motor vehicle.</u></p> <p>(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 <u>or use tax</u>, 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 <u>B</u>oard. 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 <u>or lease agreement</u> between the buyer and the dealer <u>or lessor</u> 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</p>
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AGENDA — December 17, 2013 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1655, *Returns, Defects and Replacements*

<p>Action 1 – Staff Recommendation</p>	<p>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 <u>or lessor</u> who made the retail sale <u>or lease</u> of the non-conforming motor vehicle to the buyer, and evidence <u>for one of the following</u>:</p> <ol style="list-style-type: none">1. that <u>The dealer had reported and paid sales tax on the gross receipts from that sale; or</u>2. <u>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</u>3. <u>The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of the vehicle.</u> <p>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.</p> <p>(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 <u>or use tax</u>, 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.</p>
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AGENDA — December 17, 2013 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1655, *Returns, Defects and Replacements*

Action 1 – Staff Recommendation	<u>(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.</u>
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Issue Paper Number 13-012



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposed Amendments to Regulation 1655, *Returns, Defects and Replacements*

I. Issue

Whether the Board should amend Sales and Use Tax Regulation (Regulation) 1655, *Returns, Defects and Replacements*, in order to implement, interpret, and make specific the amendments made to Civil Code sections 1793.2 and 1793.25, by Assembly Bill 242 (AB 242)(Stat. 2011, Ch. 727). These sections require the Board of Equalization (BOE) 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." Prior to AB 242, the Lemon Law only required reimbursement of sales tax or sales tax reimbursement.

II. Alternative 1 – Staff Recommendation

Staff recommends the Board approve and authorize publication of the amendments to Regulation 1655, as set forth in Exhibit 2. Staff's proposed amendments 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.
- Expanding the list of evidence required of a manufacturer when filing a claim for refund.
- Specifying that the amount of use tax that BOE 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.

For a more detailed explanation of Alternative 1 - Staff Recommendation, refer to section VI of this paper.

III. Other Alternative Considered

Do not approve proposed amendments to Regulation 1655.

IV. Background

General

The Song-Beverly Consumer Warranty Act (commencing with Civil 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 through 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California’s “Lemon Law.”

Under existing Sales and Use Tax Law, a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant to the issue in this paper, a “sale” and a “purchase” for purposes of that law. For a lease that is a “sale” and a “purchase,” the tax is measured by the rentals payable. However, 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. 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.

Prior to AB 242

Prior to AB 242, the Lemon Law 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 charges, *sales* tax, 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. These sections further required the BOE 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. The Lemon Law was silent with respect to the BOE reimbursing *use* tax to the manufacturer.

Brief Summary of Current Lemon Law (inclusive of amendments made by AB 242)

Civil Code section 1793.2

Civil Code section 1793.2 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(d)(2).)

In the case of restitution, subparagraph (d)(2)(B) 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. When restitution is made, the amount to be paid by the manufacturer to the buyer may be reduced by that amount directly attributable to use by the buyer prior to the time the buyer first delivered the vehicle for correction of the problem. (Civ. Code § 1793.2(d)(2)(C).) Subparagraph (d)(2)(D) further specifies that “pursuant to Section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

Civil Code section 1793.25

Civil Code section 1793.25 provides, in relevant part, that the BOE shall reimburse a manufacturer for an amount equal to the sales or use tax which the manufacturer (1) pays to or for a buyer or lessee when providing a replacement vehicle, or (2) includes in making restitution to the buyer or lessee, subject to satisfactory proof, as specified. (Civ. Code § 1793.25(a).)

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A manufacturer is required to provide satisfactory proof that it complied with Civil Code subdivision 1793.23(c), which pertains to inscribing the ownership certificate with the notation “Lemon Law Buyback” and affixing a decal to the vehicle, and 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. (Civ. Code § 1793.25(a).)

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. (Civ. Code § 1793.25(e).)

V. Discussion

Amendments to Civil Code sections 1793.2 and 1793.25

AB 242 made amendments to Civil Code sections 1793.2 and 1793.25 to make clear that a refund for use tax is also authorized under the Lemon Law. AB 242 also specified that the amendments were declaratory of existing law. For purposes of discussion, a summary of those amendments are as follows:

With respect to Civil Code section 1793.2:

- Amended subparagraph (d)(2)(B) to add “use tax” to the collateral charges which a buyer is entitled to receive in cases of restitution.
- Added subparagraph (d)(2)(D) which 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 Civil Code section 1793.25:

- Amended subdivision (a) to specify that the BOE 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 making restitution under the Lemon Law, and
- Expanded the satisfactory proof required of the manufacturer, under subdivision (a), to include proof that
 - 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.
- Added subdivision (e) which specifies that the amount of use tax that BOE 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.

Interested Parties Comments

BOE staff conducted an interested parties meeting to discuss the proposed amendments to Regulation 1655 on August 8, 2013. A participant inquired as to how the provisions of Regulation

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1655 would apply to a transaction in which a lessor paid tax at the time of purchase of a vehicle for which it would then lease. Staff considered the scenario and subsequent to the meeting, 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. With respect to sales tax transactions, the existing provisions of Regulation 1655 would apply. Furthermore, it was noted that the application of Regulation 1655 to sales tax transactions is beyond the scope of the current issue of whether to amend Regulation 1655 to clarify the provisions of the Lemon Law applicable to use tax transactions. Since staff did not receive any other inquiries or comments subsequent to the first interested parties meeting and had no changes to its recommendation, the second discussion paper and second interested parties meeting were canceled. Staff notified interested parties that comments may be submitted up to October 17, 2013 for consideration in the preparation of this Formal Issue Paper. Staff did not receive any other comments.

VI. Alternative 1 - Staff Recommendation

A. Description of Alternative 1

Regulation 1655, *Returns, Defects and Replacements*, provides guidance with respect to the tax reimbursement provisions of California's Lemon Law. In light of AB 242, staff recommends that Regulation 1655 be amended to:

- Incorporate the new provision of Civil Code subparagraph 1793.2(d)(2)(D) by specifying that the term buyer includes a lessee of a new motor vehicle. (Proposed amendments to subdivision (b)(2)(A).)
- Add the term "or use" where the current regulation refers to "sales tax or sales tax reimbursement." (Proposed amendments to subdivisions (b)(2)(B) and (b)(2)(C).)
- Add the term "or lease" after "sales" where the current regulation refers to "sales agreement." (Proposed amendments to subdivision (b)(2)(B).)
- Add the term "or lessor" where the current regulation references "dealer" and add the term "or lease" where the current regulation references "retail sale." (Proposed amendments to subdivision (b)(2)(B).)
- Incorporate the provisions of amended Civil Code subdivision 1793.2(a) by expanding the list of evidence required of a manufacturer when filing a claim for refund to include proof that: 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; or the lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of that motor vehicle. (Proposed amendments to subdivision (b)(2)(B).)
- Specify that the amount of use tax that BOE 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 subdivision 1793.25(e). (Proposed new subdivision (b)(2)(D).)

B. Pros of Alternative 1

- Ensures that Regulation 1655 is consistent with the amendments made to the Civil Code by AB 242.
- Clarifies that a manufacturer may file a claim for refund for an amount for use tax which the manufacturer paid to or for the buyer under the provisions of the Lemon Law.
- Provides guidance to retailers as to the satisfactory proof required when filing a claim for refund.

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C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require adoption of amendments to Regulation 1655.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1655 and thereby begin the formal rulemaking process.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation and updating manuals and publications is considered routine. Any corresponding cost associated with these activities would be absorbed within the BOE's existing budget. Staff has noted the number of claims for refund filed pursuant to the Lemon Law has increased by approximately 30 percent. Staff attributes the increase to the amendments made by AB 242 and is still evaluating personnel needs.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff believes the proposed amendments clarify, to taxpayers and staff, that a manufacturer may file a claim for refund for use tax paid to or for a buyer under the Lemon Law. In addition, the amendments specify the type of proof required of a manufacturer when it files a claim for refund.

H. Critical Time Frames of Alternative 1

None.

VII. Other Alternative

A. Description of Alternative 2

Do not amend Regulation 1655.

B. Pros of Alternative 2

The BOE would not incur the workload associated with processing the amended regulation.

C. Cons of Alternative 2

Regulation 1655 will not be entirely consistent with the amendments made to the Civil Code by AB 242 and, therefore, may cause confusion to taxpayers.

D. Statutory or Regulatory Changes for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

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F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 2

Without regulatory amendments, there may be confusion as to whether a manufacturer may file a claim for refund for use tax paid to or for a buyer under the Lemon Law. In addition, there would not be clear guidance as to the type of proof required of a manufacturer when it files a claim for refund.

H. Critical Time Frames for Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department.

Current as of: November 26, 2013

REVENUE ESTIMATESTATE OF CALIFORNIA
BOARD OF EQUALIZATION

Proposed Amendments to Regulation 1655, Returns, Defects and Replacements

I. Issue

Whether the Board should amend Sales and Use Tax Regulation (Regulation) 1655, Returns, Defects and Replacements, in order to implement, interpret, and make specific the amendments made to Civil Code sections 1793.2 and 1793.25, by Assembly Bill 242 (AB 242)(Stat. 2011, Ch. 727). These sections require the Board of Equalization (BOE) 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.” Prior to AB 242, the Lemon Law only required reimbursement of sales tax or sales tax reimbursement.

Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of the amendments to Regulation 1655, as set forth in Exhibit 2. Staff’s proposed amendments 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.
- Expanding the list of evidence required of a manufacturer when filing a claim for refund.
- Specifying that the amount of use tax that BOE 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.

II. Other Alternative Considered

Do not approve proposed amendments to Regulation 1655.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in the staff recommendation that would impact revenue. The staff recommendation implements legislation declaratory of existing law. The revenue impact for AB 242 has already been estimated in the Assembly Floor Analysis dated [September 7, 2011](#). Therefore, the proposed amendments to Regulation 1655 do not have a revenue impact.

Other Alternatives Considered

Alternative 2 – Do not approve proposed amendments to Regulation 1655.

There is nothing in Alternative 2 that would impact sales and use tax revenue.

Revenue Summary

Alternative 1 – Staff recommendation does not have a revenue impact.

Alternative 2 – Alternative 2 does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. This estimate has been reviewed by Mr. Joe Fitz, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Chief, Tax Policy Division, Sales and Use Tax Department. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of November 26, 2013.

Regulation 1655, *Returns, Defects and Replacements*

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.

(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 ~~t~~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.