

Memorandum

To: Honorable Betty T. Yee, Chairwoman
Honorable Judy Chu, Ph.D., Vice Chair
Honorable Bill Leonard, Second District
Honorable Michelle Steele, Third District
Honorable John Chiang, Controller

Date: August 2, 2007

From: Kristine Cazadd
Chief Counsel 

Subject: **Board Meeting – August 14, 2007**
Chief Counsel Matters – Item M2

Application of Tire Recycling Fee to Tires on Demonstrator Vehicles

Recently, the Legal Department received a request from a California car dealer to reconsider advice given in 2001 to the California Motor Car Dealers Association (CMCDA) with respect to the correct application of the Tire Recycling Fee Law to certain factual situations. Upon reconsideration of this 2001 advice, the Legal Department issued an opinion letter dated April 18, 2007, which made minor adjustments to the 2001 advice with respect to tires on demonstrator vehicles. In response to concerns expressed by the CMCDA regarding the possible implications of these minor adjustments, we propose clarifying the advice rendered in the April 18, 2007, letter.

To that end, the attached draft is a redacted version of a proposed letter clarifying the application of the fee to tires on demonstrator vehicles. This proposed letter addresses, to the satisfaction of the CMCDA, the concerns the CMCDA raised with regard to the April 18, 2007, letter. As the proposed letter explains, the adjustments to the 2001 advice would cause the Board's administration of the fee to more fully effectuate the Legislature's intent that the fee be paid whenever a new tire is sold in California.

Staff met with the CMCDA on July 31, 2007, to discuss various topics of interest related to the fee, including the April 18, 2007, letter and the proposed clarification of that letter. At the meeting, the CMCDA confirmed that it was amenable to the minor adjustments in question with respect to the 2001 advice, as clarified in the attached proposed letter.

If you have any further questions, please contact Tax Counsel IV Randy Ferris at (916) 322-0437 or Tax Counsel Carolee Johnstone at (916) 323-7713.

Approved: 
Ramon J. Hirsig
Executive Director

KEC:MB:CJ:ef
Bus/Use/Finals/Ferris/TireFee
Chief Counsel/Final/TireFee
Attachment: Redacted Draft of Proposed Tire Recycling Fee Letter

Item M
Sub-Item M2
8/14/2007

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Ms. Julia Findley MIC:48
Mr. Dan Tokutomi MIC:88
Ms. Susan Sinetos MIC:88
Mr. Robert Lambert MIC:82
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August 15, 2007

Ms.
Business Manager

Re: **CALIFORNIA TIRE RECYCLING FEE ACCOUNT NO.
REVISED LEGAL OPINION REGARDING DEMONSTRATOR VEHICLES
AND THE CALIFORNIA TIRE FEE**

Dear Ms. :

This letter clarifies the guidance contained in the April 18, 2007, letter I sent your company in response to a letter from a former employee of your company requesting a legal opinion regarding the California Tire Recycling Act (Act). Specifically, your company inquired as to who should pay the California Tire Fee (fee) with respect to tires on demonstrator vehicles, and when. Your company's letter referenced an earlier letter, dated January 30, 2001, from the Excise Taxes Division of the Board of Equalization (Department), to the California Motor Car Dealers Association (2001 Letter), which addressed this issue. Your company's letter requested that the position stated in the 2001 Letter be revisited and revised, due to "evolving industry and retail practices," in order "to provide clear guidance to motor vehicle dealers" regarding the reporting of the tire fee and to effectuate the Legislature's intent that the fee be paid whenever a new tire is sold.

In this letter, I will restate the guidance given in my April 18, 2007, letter, which provided a legal rationale for making a minor change (in light of the relatively few tires at issue) with respect to the reporting of the fee as to tires mounted on demonstrator vehicles. This minor change ensures that these mounted tires no longer, in effect, avoid the fee (as they did under the guidance of the 2001 Letter). Although my April 18, 2007, letter did not address the issue of spare tires, this letter clarifies that the fee treatment of spare tires for demonstrator vehicles set forth in the 2001 Letter remains the same and is substantively unaffected by the opinion expressed in my April 18, 2007, letter. Further, this letter also serves to clarify that, for purposes of auditing periods prior to the fourth quarter of 2007 (4Q07) under the Tire Fee Law, the Department will continue to follow the approach set forth in the 2001 Letter. In other words, the minor change set forth in my April 18, 2007,

Ms.

August 15, 2007

Page 2 of 7

letter, and reaffirmed herein, will not take practical effect until October 1, 2007. The delay in the practical effect of this minor change will provide sufficient time for the Department to work with the California Motor Car Dealers Association to notify affected vehicle dealers so that reporting congruent with this opinion letter can be achieved commencing in 4Q07. As the foregoing should make clear, this letter supersedes and replaces my April 18, 2007, letter.

Your company's letter asked for a "single, simple rule" for applying the fee to new tires that are installed on motor vehicles when they are purchased. As indicated above and discussed in more detail below, after considering your company's letter's discussion of the several questions at issue here, previous Board legal and staff opinions regarding the imposition of the fee, and relevant provisions of the Public Resources Code (PRC) and Vehicle Code (VC), it is our opinion that the guidance of the 2001 Letter should be revised. The following summarizes the more detailed discussion set forth in the remainder of this letter:

The California Tire Fee must be paid by every person who purchases a new tire for use as it is intended to be used with motor vehicles and specified equipment. Thus, the fee must be paid by every person who purchases new tires with a new or used motor vehicle for use as the tires are intended to be used with the new or used motor vehicle or equipment, and, where relevant, who registers the new or used motor vehicle with California Department of Motor Vehicles (DMV). In the terms used by the Act, the "retail seller" must collect the fee from the "retail purchaser."

The terms "retail purchaser" and "retail seller" are not defined in the Act or in any other law that may be construed to be related to the Act. Therefore, based on the provisions of the Act and for purposes of the Act, a "retail purchaser" is determined to be a person who purchases a new tire for use as it is intended to be used, and a "retail seller" is the person who sells the new tire to the retail purchaser. A "new tire" is any tire that is not retreaded, reused, or recycled.

In those situations where a seller timely accepts in good faith a valid resale certificate stating that a purchaser is purchasing the vehicle (inclusive of any new tires) for resale (i.e., the purchaser is a dealer), the seller is not required to collect the fee from the dealer or remit the fee to the Board. Instead, the dealer who, pursuant to the issuance of a resale certificate, purchased the new tires without paying the fee is required to self-report and pay to the Board the fee on any new tires mounted on vehicles that are put to any personal or business use besides demonstration or display (i.e., when the dealer-purchaser, for purposes of the Act, becomes a "retail purchaser").

For reporting purposes, except in the rare occurrence where it has been mounted and used on a demonstrator vehicle, a demonstrator vehicle's spare tire remains new. Thus, it is reasonable to conclude that the dealer has purchased the spare tire for resale and is storing the spare for later sale to an end user. Accordingly, under such circumstances, the person who ultimately sells a demonstrator vehicle to an end user should collect and remit to the Board the fee with respect to the spare tire at the time of such sale because the end user is the retail purchaser of the spare tire. However, if a dealer mounts a new spare tire on a vehicle while it is being used as a demonstrator vehicle, the dealer should self-report and pay the fee on that tire just like the dealer did with respect to the four tires originally mounted on the demonstrator vehicle. Additionally, if any new tires are mounted on a former demonstrator vehicle to prepare it for sale to an end user, the person making the sale to the end user should collect and remit to the Board the fee with respect to such new mounted tires.

It is our understanding that a dealer's vendor (e.g., a manufacturer) generally does not know, at the time the dealer purchases a particular vehicle, if the vehicle will be put to use exclusively for demonstration and display as part of the dealer's inventory until it is resold or if the vehicle will also be put to taxable use as a demonstrator vehicle. (See Cal. Code Regs., tit. 18, § 1669.5.) Therefore, when a timely, valid resale certificate is taken, the person from whom the dealer purchases the vehicle is relieved from liability for collecting and remitting the fee to the Board.

DISCUSSION

Background

As amended, effective January 1, 1997, the Act mandates that a fee, known as the California Tire Fee, be collected from all persons purchasing a new tire. The fee is collected to create a fund that is used to address, through a program for recycling throughout the State, the environmental and health concerns associated with the eventual disposal of those tires in landfills and stockpiles and through illegal dumping. (PRC, §§ 42861 & 42870 et seq.) In order to carry out the Legislature's intent, the fee must be collected on every new tire when it is sold to the person who uses the tire as it is intended to be used. To that end, the Act provides: "A person who purchases a new tire, as defined in subdivision (g), shall pay a California tire fee of one dollar and seventy-five cents (\$1.75) per tire." (PRC, § 42885, subd. (b)(1) [as amended effective 7/18/06] [emphasis added].) The Act also provides: "The retail seller shall collect the California tire fee from the retail purchaser at the time of sale . . ." (*Id.* at § 42885, subd. (b)(3) [emphasis added].)

However, with respect to demonstrator vehicles and the fee, the 2001 Letter states:

[T]he vehicle is first sold at retail as a used car after its demonstrator service. . . . [T]he fee is due on the first retail sale of this vehicle for all new tires. Therefore, assuming no new tires have been placed on the vehicle, four tires are used and not subject to the fee. However, since the spare tire is presumably new, and the fee has not previously been paid on it, the fee is due on the new spare tire. (2001 Letter, at p. 1.)

In other words, under the guidance of the 2001 Letter, the four tires that are mounted on and sold with the demonstrator vehicle will eventually be discarded without the fee ever being paid on them. As your company's letter points out, this result does not seem to be consistent with the Legislature's intent that the fee be collected whenever a new tire is sold.

Analysis

As it is used in the Act, the term "'new tire' means a pneumatic or solid tire intended for use with on-road or off-road motor vehicles, motorized equipment, construction equipment, or farm equipment that is sold separately from the motorized equipment, or a new tire sold with a new or used motor vehicle, as defined in Section 42803.5, including the spare tire, construction equipment, or farm equipment." (PRC, § 42885, subd. (g) [emphasis added].) Further, "'new tire' does not include retreaded, reused, or recycled tires." (*Ibid.*)

As stated in this provision, one or more new tires may be sold with both new and used motor vehicles, so when new tires mounted on a new or used motor vehicle are sold for use as they were intended to be used, such as when a dealer purchases new tires with a new or used motor vehicle that the dealer chooses to use as a demonstrator vehicle, the fee is due.

A motor vehicle is "new" until it becomes "used." Under the Vehicle Code, a "used vehicle" is one that, among other things, "has been sold, or has been registered with the [DMV], or has been sold and operated upon the highways." (VC, § 665 [emphasis added].) "Used vehicles" are also vehicles that are "unregistered [and] regularly used or operated as demonstrators in the sales work of a dealer." (*Ibid.* [emphasis added].) In other words, under the Vehicle Code, a vehicle is "used" if it is "sold," or "registered," or "sold and operated upon the highways," or is a "demonstrator." Therefore, once a motor vehicle has been put to use as a demonstrator vehicle, it becomes a "used vehicle," and the new tires that were mounted on the vehicle were sold to the dealer with the vehicle and used as they were intended to be used.

PRC section 42885, subdivision (b)(3), requires the "retail seller" to collect the "fee from the retail purchaser at the time of sale [emphasis added]." However, when a dealer purchases a new or used vehicle on which new tires are mounted, the seller may not know

Ms.

August 15, 2007

Page 5 of 7

if the dealer is a “retail purchaser,” as defined above (i.e., a person who is purchasing the new tires for use as they are intended to be used). Therefore, if the seller timely accepts in good faith a valid resale certificate stating that the dealer is purchasing the vehicle (inclusive of any new tires) for resale, for purposes of the Act, the dealer is not a “retail purchaser” and the seller is not a “retail seller” as to that wholesale transaction, and the seller is not required to collect the fee from the dealer-purchaser and remit it to the Board. However, in those situations where the dealer subsequently puts the tires to their intended use, by putting the vehicle to taxable use as a demonstrator vehicle or otherwise, the dealer becomes a “retail purchaser” who purchased the new tires to be used for their intended use and must self-report and pay the fee to the Board.

For reporting purposes, typically the spare tires associated with demonstrator vehicles remain new. With respect to a demonstrator vehicle’s new spare tire, it is reasonable to conclude that the dealer has purchased the spare for resale and is storing the spare (most likely in the trunk of the demonstrator vehicle) for ultimate sale to an end user. Accordingly, the person who ultimately sells a demonstrator vehicle to an end user should collect and remit to the Board the fee with respect to the spare tire at the time of such sale. Under such circumstances, the end user is the retail purchaser of the spare tire.

In the rare occurrence where the demonstrator vehicle’s spare tire is mounted and used on the demonstrator vehicle (e.g., as a result of one of the originally mounted tires becoming flat), the dealer should self-report and pay the fee to the Board on the spare tire. If the same (now used) spare tire is ultimately sold to the eventual end user, no fee for the spare tire would need to be collected from the end user (since it has already been self-reported by the dealer). However, if the used spare tire is replaced with a new spare tire that is then sold to the end user, then the person selling the demonstrator vehicle should collect the fee on the new spare tire from the purchaser at the time of sale and remit the fee to the Board.

In sum, it was the Legislature’s intent that the fee must be paid when a person purchases a new tire and uses the tire as it is intended to be used. Accordingly, with respect to demonstrator vehicles, a dealer who purchases a new or used motor vehicle on which new tires are mounted, and who uses the tires as they are intended to be used when the vehicle is placed in demonstrator status, must report and pay the fee on those new tires to the Board, if the fee was not paid previously.

Without disclosing the identity of you or your company, or any confidential information, Tax Counsel IV Randy Ferris of the Board’s Legal Department has confirmed that California Motor Car Dealers Association is amenable to the reporting guidance provided in this letter and believes that it would not be unduly burdensome for dealers to conform their fee reporting to this guidance by October 1, 2007. In the near future, the Legal Department and the Environmental Fees Division, after further conferring and coordinating with the California Motor Car Dealers Association, will notify the dealers affected by the above-discussed minor change to the guidance previously given in the 2001

Ms.
August 15, 2007
Page 6 of 7

Letter so that reporting will conform to the opinion provided herein for periods commencing on and after October 1, 2007.

If you have any questions regarding the information provided above or would like further assistance regarding any of these matters, please contact me as provided above or Mr. Ferris at (916) 322-0437.

Sincerely,

Carolee D. Johnstone
Tax Counsel

CDJ/

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