STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-5550

October 25, 1990

Mr. T--- D---, Jr.
XXXX --- ---
--- ---, Ca XXXXX

Dear Mr. D---:

This is in response to your letter dated September 21, 1990 regarding the application of sales tax to your purchases of vehicles. You state:

> "In 1989, I purchased a brand new automobile from P--- B--- F--- here in --- ---. To make a long story short, the car had many defects, and I ended up suing both the dealer and manufacturer for rescission of the purchase and sale agreement due to breach of warranties. To keep the story short, a settlement has been reached whereby it was agreed that I could receive either a refund of the purchase price of the car or a credit for that amount towards the purchase of a substitute car. Roughly speaking, the credit or refund is approximately $17,000 and the cost of the substitute car is expected to be approximately $18,000. Please note that the refund is not predicated on the purchase of the more expensive substitute car."

You ask whether you owe tax on the substitute car or on the difference between the credited amount and the cost of the substitute car. Initially, I note that sales tax is imposed upon the retailer of tangible personal property sold at retail in California. (Rev. & Tax. Code § 6051.) "Sales tax" as itemized on the contract of sale is actually sales tax reimbursement which the retailer is entitled to collect from the purchaser since the contract between the parties so provides. (Civ. Code § 1656.1.)

You believe that the provisions of Regulation 1655, Returned Merchandise and Defective Merchandise, support your view that tax applies only to the additional charge for the substitute car. We disagree. Since the second transaction was pursuant to settlement of litigation, we do not analyze it to determine whether it would have otherwise qualified for a deduction under Regulation 1655. That is, provisions of Regulation 1655 apply only to transactions voluntarily entered into between the buyer and the seller, and not to those entered into which are forced by litigation. Amounts paid to a buyer in order to settle litigation do not differ in any realistic sense from any other damages which might be received by a purchaser from a seller as a result of litigation arising out of a sale transaction. (See Southern California Edison Company v. State Board

of Equalization (1972) 7 Cal.3d 652.) This same analysis applies to the exchange of vehicles in order to settle litigation.

You also cite the case of Youngstown Steel v. State Board of Equalization (1957) 148 Cal.App.2d 205 which you describe as holding that refunds pursuant to rescinded contracts are excluded from taxation. That case concerned provisions in Revenue and Taxation Code sections 6011 and 6012 prior to their amendment in 1953. That case is no longer relevant.

You have not provided us with any of the relevant documents. However, it appears likely that the second transaction is structured as a sale from the automobile dealer to you with a trade-in allowance for the car that you are trading in. As such, sales tax would apply to the entire sale price for that vehicle, with no deduction on account of the credit for the trade-in. (Rev. & Tax. Code § 6012(b)(2), Reg. 1654(b)(1).)

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:wk