

Audit Manual

Chapter 6

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

Business Tax and Fee Division

*California Department of
Tax and Fee Administration*

This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda. Please contact any California Department of Tax and Fee Administration office if there are concerns regarding any section of this publication.

Table of Contents

VEHICLE, VESSEL, AND AIRCRAFT DEALERS	0600.00
INTRODUCTION — VEHICLE DEALERS	0601.00
General	0601.05
Sales of Vehicles by Non-Dealer Retailers	0601.07
Classes of Dealers	0601.10
Distributors	0601.15
Records of Distributors	0601.20
Assembly Plants	0601.25
Factory Branches	0601.30
Autobrokers	0601.45
Autobrokers Acting as Independent Retailers	0601.50
SALES RECORDS — NEW VEHICLE DEALERS	0602.00
General	0602.05
Dealer’s Standard Accounting System	0602.10
Sales Documents	0602.15
Motor Vehicle Contract and Security Agreement	0602.20
Sales Journals	0602.25
Financial Statements	0602.30
Dealer’s Sales Tax Working Papers	0602.35
AUDIT PROCEDURE — NEW VEHICLE DEALERS	0603.00
Introduction	0603.05
Interview Taxpayer’s Representative	0603.07
Use of Financial Statements	0603.10
Use of Dealer’s Sales Tax Working Papers	0603.15
Examination of General Ledger	0603.20
Sales Tax Accrual Account	0603.25
Audit Program — New Vehicle Dealers	0603.30
INTRODUCTION — USED CAR DEALERS	0604.00
General	0604.05
Used Car Wholesalers	0604.10
SALES RECORDS — USED CAR DEALERS	0605.00
Used Car Dealers’ Records	0605.05
Car Envelopes	0605.10
Auctions	0605.15
Inventory Books	0605.20
Dealers’ Reports of Sale	0605.25
Flooring and Finance Company Records	0605.30
Kelley Blue Books	0605.35
AUDIT PROCEDURES — USED CAR DEALERS	0606.00
Initial Interview	0606.05
Audit Procedures — Used Car Dealer	0606.10
Requests for DMV Information from Consumer Use Tax Section	0606.15

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

TABLE OF CONTENTS (CONTINUED)

REGULAR SALES OF NEW AND USED CARS	0607.00
General.....	0607.05
Motor Vehicle Dealer Tax Liability.....	0607.07
Vehicle Code	0607.10
Dealer's Reports of Sale	0607.15
New Vehicle Sales.....	0607.20
Used Vehicle Sales.....	0607.25
Dealer's Report of Sale as Evidence.....	0607.30
Customer Demands Certificate of Title.....	0607.32
Use of Dealer's Reports of Sale in Auditing Gross Receipts.....	0607.35
DMV Sales Data.....	0607.37
Clean Deals Test	0607.40
Form CDTFA-543, Clean Deal Questionnaire	0607.42
Examination of Sales Journals	0607.45
Vehicle Contract Data.....	0607.50
Examination of Customer Folders	0607.55
Underallowances On Trade-Ins.....	0607.60
Overallowances Taken as Discounts.....	0607.65
Discounts.....	0607.70
Rebates	0607.72
Returned Merchandise — Rescinded Sales.....	0607.75
License Fees and In Lieu Taxes.....	0607.80
Documentary Fees	0607.82
Smog Certification Fees	0607.83
Other Charges	0607.84
Lube Books.....	0607.85
Underseal and Porcelainize.....	0607.90
Delivery Charges.....	0607.95
Escrow Fees on Mobile Homes.....	0607.98
OTHER SALES OF NEW AND USED VEHICLES	0608.00
Sales of Company Cars and Service Cars.....	0608.05
Sales of Repossessions	0608.10
Sales of Salvaged Vehicles by Non-Dealers	0608.12
Transfers of Equity	0608.15
Warranties	0608.20
Transfers of Warranties	0608.25
Deductibles on Warranties	0608.30
Examination of Factory Warranty Accounts.....	0608.35
Consigned Cars.....	0608.40
Accommodation Sales.....	0608.45
Accommodation Registrations and Deliveries	0608.50
Courtesy Deliveries — Factory Directed	0608.55
Courtesy Deliveries — Factory Directed — Foreign Sales.....	0608.60
Courtesy Deliveries — Not Factory Directed.....	0608.65

AUDIT MANUAL
TABLE OF CONTENTS (CONTINUED)

SALES FOR RESALE	0609.00
General.....	0609.05
New Car Resales.....	0609.10
Resales to Leasing Companies.....	0609.15
New Car Resales to Used Car Dealers.....	0609.20
Used Car Resales	0609.25
Parts and Accessories	0609.30
Sales by Auto Auctions and Auto Dismantlers.....	0609.40
U.S. GOVERNMENT SALES.....	0610.00
U.S. Government Purchase Orders.....	0610.05
Disabled Veterans' Exemption.....	0610.10
Federal Excise Tax	0610.15
Governmental Agencies	0610.20
SALES IN INTERSTATE AND FOREIGN COMMERCE	0611.00
General.....	0611.05
Factory Deliveries at Points Outside the State.....	0611.10
Sales of Foreign Vehicles with Foreign Delivery	0611.12
Interstate Deliveries from California Stocks.....	0611.15
Bailee Clause	0611.20
One-Trip Permits	0611.25
Foreign Purchasers	0611.30
Common Carriers	0611.35
Military Personnel.....	0611.40
Overseas Deliveries	0611.45
Foreign Missions and Consuls	0611.50
LABOR AND REPAIR OPERATIONS	0612.00
General.....	0612.05
Tests of Labor Deductions.....	0612.10
Billings Based on Estimates	0612.15
Sublet Repairs (Outside Work).....	0612.20
Fabrication Labor and Special Painting.....	0612.25
Vehicle Engine Exchanges	0612.30
Repair Parts.....	0612.35
Lump Sum Repairs.....	0612.40
California Tire Recycling Fees.....	0612.45
Oil Recycling, Hazardous Waste and Other Overhead Fees	0612.50
Credit to Expense Accounts	0612.55
Modifications to Vehicles Used by Physically Handicapped Persons	0612.60
FUEL SOLD OR CONSUMED IN NEW OR USED VEHICLES	0613.00
General.....	0613.05
Fuel Sold With Vehicles.....	0613.10
Fuel Consumed In Vehicles.....	0613.15
Fuel Used In Demonstrators.....	0613.20

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

TABLE OF CONTENTS (CONTINUED)

SELF-CONSUMED MERCHANDISE	0614.00
General.....	0614.05
Manufacturers and Distributors of Motor Vehicles.....	0614.07
Vehicles Capitalized As Assets.....	0614.08
Registration	0614.09
Recording of Cars Used as Demonstrators.....	0614.10
Rental to Salespersons for Demonstration.....	0614.12
Demonstration and Display	0614.15
Types of Vehicles Not Ordinarily Sold	0614.17
Application of Tax to Demonstrators.....	0614.20
Courtesy Vehicle Loans.....	0614.25
Company Cars.....	0614.30
Service Cars	0614.35
Loans To Schools, Colleges, and Veterans' Institutions for Educational or Training Program	0614.40
Loans of Automobiles to University Employees.....	0614.42
Rentals To Other Than Employees.....	0614.45
Company and Service Car Repairs and Maintenance	0614.50
Paint Department.....	0614.55
Grease and Oil	0614.60
Miscellaneous Purchases.....	0614.65
Auto Body Repair and Paint Shop Supplies.....	0614.70
Bad Debts and Repossession Losses.....	0615.00
THE LEMON LAW	0616.00
General.....	0616.05
Definitions.....	0616.10
Restitution or Replacement	0616.15
Claim for Refund Documentation Requirements	0616.20
LEASING.....	0617.00
General.....	0617.05
Definitions — Vehicles Other Than Mobile Transportation Equipment.....	0617.10
Application of Tax to Leases Other Than of Mobile Transportation Equipment.....	0617.15
Definitions — Mobile Transportation Equipment	0617.20
Application of Tax to Leases of Mobile Transportation Equipment.....	0617.25
Special Factors when Tax Reported On Rentals.....	0617.30

AUDIT MANUAL
TABLE OF CONTENTS (CONTINUED)

LOCAL USE TAX ALLOCATION ON LEASES OF MOTOR VEHICLES.....	0618.00
General.....	0618.05
Determining the Allocation of Local Tax.....	0618.10
TRANSACTIONS (SALES) AND USE TAX.....	0620.00
NEW OR REMANUFACTURED TRUCKS,TRUCK TRACTORS,TRAILERS, OR SEMITRAILERS	0625.00
Truck Manufacturers — General	0625.05
Trucks and Trailers Sold by Out-of-State Retailers	0625.10
Trailers Sold For Use Out-of-State or In Interstate or Foreign Commerce.....	0625.15
Trucks and Trailers Sold to Lessors of Mobile Transportation Equipment	0625.20
FARM EQUIPMENT AND MACHINERY— PARTIAL EXEMPTION.....	0626.00
General.....	0626.05
Qualified Vehicles	0626.10
Qualified Person	0626.15
Proof of Exemption	0626.20
Auditor’s Responsibility	0626.25
VESSEL DEALERS	0630.00
General.....	0630.05
Definition.....	0630.10
Source Data.....	0630.15
Application of Tax on Sale and Purchase of Vessels.....	0630.20
Audit Procedures	0630.25
Yacht And Ship Brokers.....	0630.30
Out-of-State Delivery	0630.35
Regulation 1594 Exemptions.....	0630.40
Commercial Deep Sea Fishing Vessels	0630.45
AIRCRAFT DEALERS	0635.00
General.....	0635.05
Definition.....	0635.10
Source Data.....	0635.15
Application of Tax on Sale and Purchase of Aircraft.....	0635.20
Audit Procedures	0635.25
Co-Owners	0635.30
Use In California	0635.35
VEHICLE INDUSTRY — TERMINOLOGY — REGULATIONS.....	0640.00
Terminology	0640.05
Sales Tax Regulations Pertaining To Automobile Dealers.....	0640.10

VEHICLE, VESSEL, AND AIRCRAFT DEALERS 0600.00

INTRODUCTION — VEHICLE DEALERS 0601.00

GENERAL 0601.05

A motor vehicle is generally defined as a device which is self-propelled, such as an automobile or truck, and used on a highway to move persons or property. (For the specific definitions see Revenue and Taxation Code (RTC) sections 6022 and 6272.) The material included in this chapter not only applies to audits and records of motor vehicle dealers, but also applies to audits of the records of any seller whose transactions are similar to those of a motor vehicle dealer, such as dealers of house trailers, motorcycles, recreational vehicles, jet skis, snowmobiles and tractors.

Exhibit 2 lists sources of information, which may be helpful for both audit and compliance purposes and which are available to staff via the Internet.

SALES OF VEHICLES BY NON-DEALER RETAILERS 0601.07

RTC section 6282 provides an exemption for sales tax on the sales of vehicles required to be registered under the Vehicle Code when the retailer is not a licensed manufacturer, remanufacturer, dealer, dismantler, or lessor-retailer. Under such circumstances, RTC section 6292 provides that the purchaser is required to pay the applicable use tax to the Department of Motor Vehicles (DMV) when registering the vehicle. Therefore, the sale of a vehicle by a non-dealer retailer (e.g., an auctioneer who is not a registered dealer) is exempt from sales tax when such vehicle is required to be registered under the Vehicle Code.

The exemption applies regardless of whether the purchaser will ultimately register the vehicle with the California DMV or a similar out-of-state agency. As such, DMV registration documents or similar registration documents from another state are sufficient to establish that the vehicle sold is a vehicle required to be registered under the Vehicle Code or similar out-of-state law codes.

CLASSES OF DEALERS 0601.10

Motor vehicle dealers may be divided into the following classes:

1. Distributors
2. Assembly Plants
3. Factory Branches
4. New Car Dealers
5. Used Car Dealers
6. Wholesale Only
7. Automobile Brokers
8. Leasing Companies

Distributors occasionally are also new car dealers, and new car dealers usually sell used cars.

DISTRIBUTORS 0601.15

There are two types of distributors with which auditors usually come in contact:

- Several automobile manufacturers maintain zone or regional offices for each of their divisions within California. The functions of these offices include distribution of new automobiles to franchised dealers.
- Separate entities also are granted exclusive rights of distribution by the manufacturer. This type of distributor sometimes serves as a new car dealer.

Also, there are other types of distributorships or variations to those described above.

RECORDS OF DISTRIBUTORS

0601.20

Factory requirements and relationships with dealers usually require a distributor to maintain records of a type which are adequate for sales tax auditing purposes.

ASSEMBLY PLANTS

0601.25

Certain larger manufacturers have established assembly plants at points within California to better serve their distributors. Such assembly plants seldom function as distributors, but rather take the place of the factory as a source of supply of certain models. Assembly plants are not licensed by the Department of Motor Vehicles (DMV), and tax is reported by the dealer who reports the sale to DMV. (See section 0608.50)

FACTORY BRANCHES

0601.30

Certain manufacturing divisions have factory branches which operate as new car dealers securing their new automobiles through the zone office or function both as new car dealers and distributors.

AUTOBROKERS

0601.45

Autobrokers are licensed dealers who, for a fee or other consideration, provide the service of arranging, negotiating, or assisting the purchase of new or used motor vehicles, not owned by the brokers. Operations vary depending on the relationship with their clients. They may act as an agent for either the buyer or the seller, or they may act as an independent agent.

Effective January 1, 1995, the Vehicle Code was amended to provide that persons acting as brokers are prohibited from buying and selling new motor vehicles for their own account. Under Vehicle Code section 11713.1(f)(1), it is now a violation of a dealer's license to advertise for sale or sell a new motor vehicle for which the dealer does not hold a franchise. A dealer registered with DMV as an autobroker may advertise its services of arranging or negotiating the purchase of a new car from a franchised new car dealer. The intent of the new law is for new motor vehicles to be sold to consumers only by those dealers who hold a franchise for the vehicle in question.

Examples of the application of tax for broker transactions are as follows:

- If the car dealer bills the broker's client for the motor vehicle, with the autobroker acting as agent of the buyer, the tax will apply to the amount billed by the dealer. The fee charged by the autobroker is not subject to tax.
- If the car dealer bills the customer for the motor vehicle, with the autobroker acting as agent of the selling dealer, the tax will apply to the amount billed by the dealer. No deduction can be taken by the dealer for commissions paid to the autobroker.

Autobrokers are required to have a dealer's license with an autobroker endorsement and a sellers' permit. Auditors should be aware that the Vehicle Code requires autobrokers to complete and maintain an autobroker log on all brokered transactions. The log contains the VIN, date of brokering agreement, name of consumer, and the selling dealer's name and dealer number. The log is kept for three years and is the property of DMV, to be made available for inspection at any time.

There are no guidelines that will enable the auditor to determine in which capacity the autobroker is acting in every situation. Each transaction must stand on its own merits. Generally speaking, however, the autobroker will receive a commission from his or her principal and may or may not be empowered to act for the principal in signing car orders and other documents pertaining to the transaction.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

AUTOBROKERS ACTING AS INDEPENDENT RETAILERS

0601.50

Unless these transactions are in violation of Vehicle Code section 11713.1(f) (see below for discussion), the auto broker is the retailer when:

- a. The auto broker agrees in advance to secure a motor vehicle for a client at a specified price. It is immaterial that the car dealer bills the auto broker or the auto broker's client.
- b. The car dealer bills the auto broker for the motor vehicle and the auto broker in turn bills the client.
- c. The auto broker files a "Dealer's Report of Sale" for the sale of a motor vehicle that the auto broker arranged between private parties.

Auto brokers are required to report and pay sales tax on sales of vehicles when they are the retailer for sales and use tax purposes.

The Vehicle Code prohibits a dealer-broker from purchasing a new motor vehicle for resale of a line-make for which the dealer-broker does not hold a franchise. This violation of the dealer's license would provide sufficient cause to disallow acceptance of a resale certificate in good faith. New car dealers should be advised not to accept a resale certificate for this type of transaction. The violation of Vehicle Code section 11713.1 is sufficient to overcome the presumption of a good faith acceptance of a resale certificate, whether or not it contains a statement that the specific vehicle is being purchased for resale in the regular course of business. (See section 0609.20 for exceptions to this policy)

When these types of transactions are encountered in audits of franchised dealers, CDTFA-1164 should be prepared for questionable transactions, e.g., a Ford dealer accepting a resale certificate for the purchase of a new Ford vehicle from a dealer not franchised to sell Ford vehicles.

Auto brokers who intend to bill their clients for the vehicle should advise the dealer of the amount of sales tax to be charged. If the amount of tax charged by the dealer is sufficient to cover the auto broker's selling price to his or her customer, there is no additional liability to the auto broker. However, leads on the dealer charging the sales tax should be prepared, as it sometimes occurs that the dealer's invoice does not reflect this charge. An example follows:

	Invoice in Autobroker's File From Dealer	Invoice in Dealer's File to Autobroker
Motor Vehicle	\$12,000	\$12,152
Sales Tax on \$14,000 (@ 8.25%)	1,155	1,003 (\$12,152)(.0825)
	\$13,155	\$13,155

The tax due from the dealer in this case is \$1,155. When auditing dealers who sell to autobrokers, auditors should check for evidence of tax on an amount greater than the selling price reflected in the dealer's records.

SALES RECORDS — NEW VEHICLE DEALERS

0602.00

GENERAL

0602.05

The sales records of motor vehicle dealers who maintain adequate accounting systems are usually similar to those described in sections 0602.10 to 0602.35.

DEALER'S STANDARD ACCOUNTING SYSTEM

0602.10

General

Most accounting records are produced in-house using software purchased from vendors such as ADP, Universal Computer Consulting, Reynolds & Reynolds, etc. To make efficient use of the accounting system, most dealers organize their accounting tasks into daily, weekly, and monthly procedures.

Daily procedures include entering customer names and new vehicle units, printing a summary cash deposit report, and verifying totals after posting. On a weekly basis, selected schedules are printed such as car inventories and finance contracts, and a review is made for posting errors. Past due accounts receivable reports are printed. Monthly procedures involve closing accounts receivable, paying open items in accounts payable and generating an accounts payable report. Month-to-date postings are made to the journals, a summary general ledger is prepared, and income statement, balance sheet and month to date account balances are printed. Financial statements and monthly status reports are prepared. Status reports include profit and loss information for each department, unit analysis information, budget analysis, sales information, and accounts receivable history. A current inventory list is also printed. Finally, the accounting month is closed and a new month is set up. When the auditor encounters difficulty in tracing summary figures to source documents or in isolating certain types of transactions for examination, the dealer's assistance should be solicited. Dealer personnel often trace or isolate data in the day-to-day operation of the business and may have developed timesaving techniques which can expedite the auditor's verification.

Journals

A typical dealership's journals are numbered with standard codes such as new car sales may be source 10 or journal 10, used car sales may be source 20 or journal 20, etc. The detail of each transaction is listed vertically in account number sequence within document number sequence. The last page of each journal summarizes the entries to each account. These summary figures can be traced directly into the general ledger. Control numbers, which can be car deal numbers, customer numbers, stock numbers, etc., depending on the journal, are also listed.

General Ledger

A separate general ledger is printed for each month of the year. In addition, an annual general ledger is printed at the end of the accounting year, listing all entries during the year. The ledger is of typical format and entries are readily traceable to the journals.

Stock Book

This journal typically lists each vehicle delivered to the dealership in chronological order. Depending on the person maintaining this book, it could be a more complete listing of customer name, date vehicle received and sold, VIN#, etc. A stock book is normally not kept with the journals and general ledgers and may not be readily available in the dealership's accounting department. Review of this book can help in identifying sales not recorded in the sales journal, courtesy deliveries, and vehicles which have remained in inventory for long periods (house cars and demonstrators).

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SALES DOCUMENTS

0602.15

There are three types of billings used by most automobile dealers:

- a. Motor Vehicle Contract and Security Agreement.
- b. Parts and accessory counter sales invoices.
- c. Repair orders.

MOTOR VEHICLE CONTRACT AND SECURITY AGREEMENT

0602.20

Most dealers use a motor vehicle contract and security agreement as the basic sales document. Vehicle contracts usually contain four copies with one copy filed in the deal jacket, one copy given to the customer, one copy provided to the financing company, and the fourth copy for other dealer files. Sales information from the vehicle contract is usually transcribed to the deal jacket, which forms the basis of postings to the car journal. Some dealers may prepare a vehicle sales invoice to post the information from the contract to the journal.

SALES JOURNALS

0602.25

The journals normally used by new car dealers are:

- a. New Car Retail.
- b. New Car Fleet.
- c. New Car Commercial.
- d. Used Car.
- e. Parts, Accessory, and Service.
- f. Internal.

FINANCIAL STATEMENTS

0602.30

Most new car dealers will have adequate records, particularly where accounting systems prescribed by major automobile manufacturers are used.

Included in these records are monthly financial statements prepared on forms furnished by the manufacturer or distributor which will reflect the dealer's operations in considerable detail. They will include all the sales posted to the general ledger sales accounts from the various sales journals, as described in section 0602.25 as well as those sales posted from the general or standard journals.

DEALER'S SALES TAX WORKING PAPERS

0602.35

The majority of dealers prepare and retain working papers in support of each sales tax return. The format and amount of detail vary. In all audits, it is necessary that the auditor examine this data thoroughly to establish method of reporting, sources of amounts, and consistency of reporting procedures.

AUDIT PROCEDURE — NEW VEHICLE DEALERS

0603.00

INTRODUCTION

0603.05

In general, an audit of a motor vehicle dealer follows the same pattern as an audit of any other seller. It should be noted that a new car dealer's operations are departmentalized, with records which reflect specialization.

INTERVIEW TAXPAYER'S REPRESENTATIVE

0603.07

The auditor should interview the business manager or taxpayer's representative prior to beginning the audit work. The auditor should inquire about method of sales tax worksheet preparation, identify the source of the figures (financial statement, general ledger, journals, vehicle contracts, etc.), and determine whether the worksheets are reliable. The auditor also should determine the "Demo Policy" with respect to employees, non-employees and family members, determine to whom the demos were assigned and the source of this information, establish the method of claiming exempt sales and ask how courtesy deliveries are recorded.

USE OF FINANCIAL STATEMENTS

0603.10

Sales per the financial statements (Section 0602.30) should be traced to the sales tax working papers. An acceptable practice is to transcribe annual totals as the base amount for comparison with reported sales for the particular year. Some car dealers may report only taxable sales. Therefore, reconciliation between recorded sales per financial statement and reported sales per the sales tax return may not be meaningful. In this case, the auditor would disregard financial statement totals and transcribe sales from the general ledger.

The auditor should bear in mind that sales per financial statements do not necessarily include all sales, nor do they reflect the proper amounts of all allowable deductions.

It should be noted that total sales per financial statements ordinarily are net of discounts and overallowances. (See sections 0607.65 and 0607.70) Also, courtesy deliveries will not be shown since the delivering dealer is not making the actual sale, although the delivering dealer is the retailer liable for tax on the sale under Law section 6007.

USE OF DEALER'S SALES TAX WORKING PAPERS

0603.15

The dealer's supporting schedules can be an important factor in determining audit procedures and the extent of examination and tests. It is recommended that the first step in the audit be a detailed examination of the dealer's working papers and returns for the audit period. These schedules can provide the base amounts of audited sales and deductions and save valuable audit time. Verification of recorded detail may be made directly to the dealer's working papers avoiding unnecessary scheduling. Some dealers attach copies of the sales tax accrual account which could expedite the reconciliation of the tax accrual. Exempt transactions may be listed in detail making it easier for the auditor to verify them. Demos and courtesy delivery transactions may be listed and could form the basis of their examination.

EXAMINATION OF GENERAL LEDGER

0603.20

General ledger accounts must be examined to determine postings of sales to proper accounts, and also the posting of all accounts in conformance with acceptable accounting procedures. Analysis of the ledger accounts together with the comprehensive examination of sales tax working papers will help the auditor formulate an audit program.

SALES TAX ACCRUAL ACCOUNT

0603.25

An analysis of the sales tax accrual account should be made as it may disclose leads to unreported sales or to excessive deductions. A sales tax accrual account showing credits only slightly in excess of taxes paid, or payments in excess of collections, does not necessarily indicate errors in reporting.

In reconciling the accrual account, the auditor should adjust for tax on the measure of bad debts claimed, refunds of tax to customers who were charged in error, and for any other instances where taxpayer did not debit accrual account where such a charge was in order. Auditors should also adjust for such items as reported self-consumed merchandise, rental receipts on demonstrators and any other sales reported on which taxpayer did not accrue tax. If, after making the above adjustments, an excess debit or credit of tax still exists, tests should be made of the various journals, comparing the accrual with recorded taxable sales from the respective journal. Excess tax accrued may indicate the dealer made unreported courtesy deliveries or collected sales tax reimbursement on cap reduction and down payment on leased vehicles. Auditors should place emphasis on examining adjustments made to the accrual account and trace to journal entries.

The measure of sales tax accruals from cash receipts and general journal entries should be traced to taxable measure reported.

When sales tax reimbursement is computed on an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the dealer, the amount paid is excess tax reimbursement as defined in Regulation 1700(b). When the auditor ascertains that excess tax reimbursement was collected, the dealer will be afforded an opportunity to refund the excess collections to the customer. In event of failure or refusal of the person to make such refunds, the auditor will include the measure of excess tax reimbursement in the audit.

The following areas are recommended for audits of new vehicle dealers:

	Records	Purpose	Scope of Examination
Initial Examination	Sales Tax Work Paper (STWP)	Method of Reporting and Consistency	Audit Period
	General Ledger	Account Procedures Unusual Postings	Audit Period
	Financial Statements	Comparison with STWP to Establish Base of Audited Amounts	Audit Period
	Sales Tax Accrual Account	Indications of Consistent Over-accruals or Substantial Amount in Specific Periods	Initial Reconciliation at Inception of Audit. Adjust Findings as Differences are Explained or Upon Findings That Accruals were Not Made
Total Sales	Sales Journals & General Journal	Examination of Content, Credit Postings to Other Than Sales Accounts	Audit Period
	Customer Folders	Agreement of Documents Contents with Folders	Variable
	Car Invoices (Posting Copies)	Agreement with Records	Variable
	New Car Purchase Journal	Dealer Transfers and Courtesy Deliveries	Audit Period
	Cash Receipts Journal	Additional Sales	Audit Period
	DMV Report of Sale	Additional Sales	Variable
	Fixed Asset Accounts	Sales of Fixed Assets	Audit Period
Self Consumed & Use Tax	Company Car — Demonstrator Account	Indication of Demonstrators, Company Cars	Audit Period
	Fixed Asset Accounts	Self Consumption	Audit Period
	Internal Journal	Self Consumption on Company Cars	Variable
	Purchase Invoices	Self Consumed and Use Tax Purchases	Variable
Sale for Resale	New Car Sales Journals & DMV Books	Sales to Leasing Companies and Registration Date	Audit Period
	Used Car Journal	Valid Resales	Audit Period
	Counter Invoices & Parts And Accessories Journal	Validity of Resales & Composition of Postings	Variable
U.S. Gov't & Interstate Commerce Sales	STWP — Customer Folders Car Journals	Composition of Deduction & Supporting Documents	Audit Period

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

AUDIT PROGRAM — NEW VEHICLE DEALERS

(CONT) 0603.30

	Records	Purpose	Scope of Examination
Motor Vehicle Fuel Tax Paid Purchases Resold	Sales Journal STWP	Validity of Deduction	Variable
Labor Sales	Service Journal	Composition	Variable
	Repair Orders	Validity of Claimed Labor	Variable
	Purchase Invoices	Composition of Sublet	Variable
	Insurance Estimates	Difference between Repair Order and Estimates	Variable
Bad Debts — Repossessions	STWP — Repo Loss Schedule	Accuracy of Deduction	Variable
	Cash Receipts Collection Agency Statements	Recoveries of Bad Debt	Variable
Common Carrier Exemption	Exemption Certificates	Validity of Deduction	Audit Period

INTRODUCTION — USED CAR DEALERS

0604.00

GENERAL

0604.05

The majority of the subject matter in the preceding sections pertains to new car dealer's operations. While the new car dealer will have a used car department, whose operation is confined to used car sales, the accounting procedures and controls inherent in the cost accounting system cause the new car dealer's used car operation to be considerably different from a used car dealer's operation from an auditing standpoint. Since most used car dealers do not repair customer cars after the customer's purchase, they normally have no service department. However, many dealers maintain a mechanic or have reconditioning facilities to prepare newly acquired vehicles for resale. Many of the preceding sections will apply in their entirety to a used car dealer's operations.

USED CAR WHOLESALERS

0604. 10

One unique type of used car operation is that of used car wholesalers. They are usually located in the metropolitan areas and sell to dealers within a radius of 200 — 300 miles. The majority of their sales are to used car dealers, but some retail sales are made. The sources of purchase vary but the bulk of cars are procured from large dealers, leasing companies, fleet users, and out-of-state wholesalers. The operation is based on quick turnover at small margin of profit (\$25 — \$50 per unit). While this type of operation usually requires detailed records, volume alone is the cause of errors. Since retail sales are usually few in number, by comparison with total units sold, it is desirable to trace all sales per Dealer Report of Sale Books to the recorded taxable sales. The most common sources of errors, however, are the lack of supporting resale certificates, and incomplete wholesale car orders which incorporate the resale certificate. A detailed examination of claimed resales with special emphasis on "one-shot" sales is often in order.

SALES RECORDS — USED CAR DEALERS 0605.00**USED CAR DEALERS' RECORDS 0605.05**

The books and records of dealers handling used cars exclusively are not usually as extensive or detailed as those of new car dealers or distributors since, unlike the new car dealers, they are under no compulsion to maintain certain types of records. Although some used car dealers will employ a double entry system and exert excellent control of purchases inventories and expenses, most use a single entry system with varying degrees of control.

A common means of control in used car dealer's records are car envelopes and inventory books. In all instances, the certificated used car dealer will be issued Used Vehicle Report of Sale Books by DMV.

Those dealers selling late model used cars will in most cases have flooring loans on purchases and sell on conditional sales contracts with recourse.

CAR ENVELOPES 0605.10

The majority of used car dealers will utilize car envelopes (Also referred to as a car jacket, customer file or deal jacket) rather than the customer folders used by new car dealers. Cars purchased are normally assigned an inventory number with a car envelope prepared for the unit. Details of purchase and sale are placed on the appropriate lines on the printed face of the envelope, and all documents of purchase, reconditioning and sale are inserted in the envelope.

Car envelopes are sometimes the only records maintained or available, and reporting for sales tax is based on tapes prepared from car envelope data. In such cases, the auditor's verification should consist of the sequence and completeness of inventory numbering, a test of contents of the car envelopes, reconciliation with DMV Dealer's Reports of Sale and correctness of reporting.

To account for all the vehicles purchased, it is necessary for the auditor to recognize the various sources of purchases. Dealers acquire cars from trade-ins on sale of used vehicles, purchases of used cars from individuals, other new and used car dealers, or wholesale or retail auctions.

Source of revenue in addition to sales from the lot include consignment sale (See section 0608.40) of vehicles by individuals and dealers, and sale at auctions.

AUCTIONS 0605.15

Dealers buy and sell cars at wholesale and retail at auctions. Wholesale auctions permit only dealers to buy or sell, while retail auctions are open to the general public as well. Each auction is run independently, maintains different records, and has its own procedures. Some standard auction procedures may include:

- Every dealer must register with the auction.
- The dealer will provide the auction with the year, make, VIN, and equipment of each vehicle offered for sale.
- The auction will issue the selling dealer an auction check, and assume the risk of collection on the buyer's check.
- The auction will handle the actual assignment of title to the buyer and collect and report the sales tax.
- The seller may set a floor or lowest price that the car may be sold for by the auction.
- Each party will receive an invoice that shows the vehicle sold and the identities of the buyer and seller.

AUCTIONS**(CONT.) 0605.15**

Some dealers may bring a customer to a wholesale auction, in violation of auction policy, and collect an auction fee for their service. In this case, the auction sells the car to the dealer for resale and the dealer gives the paperwork to the customer with instructions to register the vehicle at DMV. The vehicle is not entered in the car dealer's inventory or sales records. The auditor needs to be alert for these transactions as the buyer may not report the correct amount of tax.

REQUESTING AUCTION HOUSE DATA

Some dealers purchase large amounts of vehicles from auctions. The Data Analysis Section (DAS) maintains an auction house database of wholesale used car sales based on information obtained from the largest known auction houses. The database includes the following information:

- Auctioneer name
- Purchaser's name and address
- Purchase date
- Description of vehicle purchased (VIN, make, model)
- Purchase price

The above information may be of assistance when verifying reported taxable sales, identifying a dealer on non-dealer's purchases, projecting or supporting an estimated tax liability, or ensuring compliance with other registration and reporting requirements.

Auditors must first request available auction house data from DAS prior to contacting any wholesale auction house. Requests should be sent via email to DataReq@cdtfa.ca.gov with "Auction House Data" in the subject line. DAS will provide the matching auction purchase data with a list of auction houses searched. If DAS does not have the requested data available, the auditor may send a written request for data to the appropriate auction house(s) that were not searched.

All requests for auction house data should include the owner's name, DBA, business address and seller's permit number, at a minimum.

INVENTORY BOOKS**0605.20**

Some dealers will record all purchases in an inventory book and employ this book as a combination purchase and sales journal. Detail of source of purchase, date, description and cost are entered reflecting the purchase. The date of sale, name of customer, and selling price are recorded at the time of sale.

The lag in time that exists on some sales is a major difficulty in this type of accounting. The dealer may omit sales of units purchased in quarters prior to the period of sale. Dealers' Reports of Sale should be tested extensively in these audits to determine completeness of sales records.

Auditors should ask the taxpayer or representative how sales were recorded and if any credit sales were made. Auditors should also review the available records to determine recurring payments from individuals. Such recurring payments should be traced to the original sale to determine if the sale was properly recorded and reported. Other sources of unreported sales are:

- Not recording a trade-in on a sale, then selling the trade-in for cash. The dealer keeps the cash and the title shows a direct sale from customer A to customer B with no indication that the dealer was ever involved in the trade.
- Analysis of bank deposits and canceled checks may show unidentified cash deposits or reconditioning costs incurred but not allocated to vehicles.
- Not reporting the sale of all cars purchased. Comparing the purchase of a vehicle acquired by trade and at auctions to a subsequent sale of the vehicle can determine the accuracy of recorded sales.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

INVENTORY BOOKS

(CONT.) 0605.20

- Purchasing packaged cars, allocating the full cost of the package to only some of the units, then selling one or more units off the books. A review of purchase documents may provide evidence of the number of cars purchased. Packaged purchases are often made from other dealers or auctions.
- Many dealers engaged in “Buy Here/Pay Here” operations may repossess the same vehicle several times before it is ultimately sold. The dealer reports the sale on the first repossession, but not on subsequent repossessions.

DEALERS' REPORTS OF SALE

0605.25

The only record common to all used car dealers is the Report of Sale Book. While they are still referred to as 'books,' DMV has changed the Report of Sale to a loose-leaf form. This may cause some problems with obtaining complete sets of Report of Sales Books for examination. Use of the books to determine the completeness of the recorded sales is standard procedure. The extent of examination of Reports of Sales depends on size of operation, class of merchandise, and type of formal records maintained.

It should be noted that preparation of Report of Sale requires the remittance of license or transfer fee. The remittance is usually made along with DMV Form 247, which contains information regarding Report of Sale number, or license number, and amount of license or fees remitted. If the auditor suspects that all books have not been made available, an examination of the duplicate copies of DMV Form 247 retained by the dealer is a ready source for comparison.

The auditor should examine voided Reports of Sale carefully. Although these may be legitimate voids, they could represent sales made without corresponding entry in the sales records.

FLOORING AND FINANCE COMPANY RECORDS

0605.30

Dealers who sell late-model used cars often enter into flooring loans on purchases. In audits of dealers with sparse records, or if the auditor suspects that incomplete data has been furnished, examination of flooring contracts or financing agreements in the hands of the dealer or located at the lending institution is a means of verification.

A dealer financing his or her own sales (Buy Here/Pay Here Lot) will generally collect on the notes either on periodic payments or by selling the note at a discount. A dealer self-financing a sale will customarily keep a financing file which should be examined for leads of unrecorded sales of vehicles.

KELLEY BLUE BOOKS

0605.35

Often, the auditor will establish unrecorded sales through audit procedures discussed in the above sections, with the establishment of reasonable selling prices the only unresolved factor. The most common reference guide is the Kelley Blue Book. The use of the suggested selling prices in the Kelley Blue Book eliminates arbitrary or unfounded prices. The Kelley Blue Book serves only as the starting point, and adjustments must be made for the actual condition of the car, since the Blue Book assumes an average condition. Factors to consider in adjusting the Blue Book price include actual wear and tear on the car, mileage, accessories, any hidden damage such as frame damage, etc.

AUDIT PROCEDURES — USED CAR DEALERS**0606.00****INITIAL INTERVIEW****0606.05**

The initial interview is crucial to the audit process and the auditor should ask certain specific industry related questions. The auditor should determine the method of reporting, and what types of records are maintained that list or summarize the business transactions. The auditor should also determine the source of purchases, if any sales or purchases are made at auctions, if there are sales for resale to wholesalers, consignment sales, and any in-house dealer financing sales or third party financing. The specific bank account(s) where sales are deposited should be identified. The auditor should inquire as to expenses paid out in cash. The auditor should determine whether the dealer or any family members own their vehicles or are allowed to drive vehicles off the lot.

AUDIT PROCEDURES — USED CAR DEALER**0606.10**

The following audit procedures are recommended for used car dealers. They are not necessarily performed in the order presented.

1. Call the Department of Motor Vehicles (DMV), preferably prior to the initial appointment, for retail and wholesale Report of Sale book numbers issued during the audit period and for information on dealer plates (quantity and plate number). Refer to section 0607.35.
2. Obtain a transcript of returns (CDTFA-414-M) from the system. Obtain it again near the completion of the audit to verify that no adjustments have been made that affect your audit results.
3. Find out who prepared the returns during the audit period. Have them show you the source(s) of the figures.
4. Tour the business location. Determine the level of business activity and lot size. Check for additional sources of income such as body shop or repair garage and other items for sale (i.e., boats, recreational vehicles, motorcycles, campers, etc). Keep in mind that used car dealers may not restrict themselves to accepting vehicles as trade-in.
5. Locate all books/records available for audit, including DMV Report of Sale books, dealer jackets, and inventory books.
6. Using the information from DMV, verify all DMV Report of Sale books are on hand. Verify that all sales were posted and reported by tracing sales from the Report of Sale books to ledgers or worksheets.
7. Review the sales tax return worksheets for accuracy, consistency, and method of reporting.
8. Reconcile reported sales per CDTFA-414-M to books, Federal Income Tax Returns (FITR), and financial statements.
9. Calculate the book markup. Do a short shelf-test, if necessary, to verify the book markup or cite industry standard.
10. If a general ledger exists, scan for unusual entries such as debits to sales and credits to cost of goods sold. Look for miscellaneous sales of assets, sales to employees, brokered sales, consignment sales, etc.
11. Analyze the sales tax accrual account.
12. Examine a representative number of sales contracts for accurate computation of sales tax. Verify that doc fees, smog fees, trade-ins are handled correctly (i.e., trade-ins are not netted from sales price).
13. Trace a representative number of sales contracts to recorded sales. Check for posting accuracy.

Audit Procedures — Used Car Dealer (Cont) 0606.10

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

AUDIT PROCEDURES - USED CAR DEALER

(CONT.) 0606.10

14. Verify proper application and allocation of transactions (sales) and use (district) taxes — the registration address is considered place of business, for district tax purposes.
15. Verify proper allocation of the 1% local use tax on certain long-term leases, effective 1-1-96 (section 0618.10).
16. Verify unwinds or rollbacks are handled correctly.
17. Determine accuracy of recorded purchases and contact vendors if necessary. Trace a representative sample of vehicle purchases from source documents to sales records or inventory.
18. If accounting records are nonexistent or incomplete, indirect methods may be employed (section 0406.00), e.g., cash flow analysis. Determine if the net income on FITR or financial statements supports taxpayer's lifestyle.
19. Verify deductions
 - a. Sales for resale — examine resale certificates, qualifying purchase orders, valid Mexican merchant cards, etc.
 - b. Interstate commerce — examine bills of lading, shipping documents, notarized out-of-state delivery statements, registration information.
 - c. Sales to Indians — examine delivery statement (on reservation), evidence of transfer of title on the reservation, evidence of tribal membership, evidence of residence on reservation, check for sale to Indian and non-Indian spouse.
 - d. Repossession losses — examine the original sales documents in the deal jackets for correct repo loss computations.
 - e. Tax-paid purchases of fuel resold with vehicles — verify accuracy of deduction. If not claimed, obtain claim for refund from the taxpayer and allow credit in audit if properly supported.
20. Check for potential use tax liability
 - a. Fixed assets — i.e., loaner cars or shuttle service vehicles
 - b. Consumable supplies
 - c. Personal use of ex-tax inventory — i.e., vehicles registered to the owner or family members or friends.
 - Check odometer statements (especially on expensive cars), comparing the mileage when purchased to the mileage when sold. Large differences may indicate unrecorded personal use.
 - Examine vehicles remaining in inventory for extended periods. This may indicate personal use.

**REQUESTS FOR DMV INFORMATION FROM
CONSUMER USE TAX SECTION****0606.15**

The Consumer Use Tax Section (CUTS) may be contacted to resolve issues between the audit staff and the taxpayer as to whether the use tax was paid to DMV by a taxpayer on a purchase of a vehicle or undocumented vessel.

CUTS has on-line access to DMV vehicle/undocumented vessel registration and use tax payment information. The basic record is referred to as an R67 inquiry and contains a description of the vehicle/undocumented vessel, registration card and ownership certificate issue dates, and name and address of the registered owner. Several subrecords can be found in this basic record including Sub: B which may indicate whether use tax was paid. The code "1" is used to indicate use tax was paid and "2" to indicate that no use tax was paid. For a complete list of R67 information and status codes see Exhibit 1.

Additional documents available from DMV include Registration Receipt, Certificate of Title (pink slip), Bill of Sale, Statement of Fact, Power of Attorney, and other documents provided to DMV upon registration.

Auditors needing DMV registration or use tax payment information should submit all requests by email to *BTFD-CUTS DMV Search for D/O Audits*. If necessary, provide additional information or comments in the body of the email. When the request involves multiple vehicles and/or vessels, the requested information should be submitted in an Excel spreadsheet and sent as an attachment. Auditors should include the following information with their email requests:

- Vehicle Identification Number (VIN) or Vessel Hull Identification Number (HIN)
- Date of Sale
- License plate number or permanent vessel registration (CF) number (if available)

Due to the potential volume of requests, these requests should not be made on a routine basis. Auditors should only request DMV information when it is needed to resolve an issue with the taxpayer and to complete the audit. When the taxpayer provides the auditor with sufficient documentation to support the purchase price, tax paid, etc., the request should not be made. However, auditors are encouraged to request DMV information from CUTS whenever it is warranted and will assist in completing the audit.

Occasionally, a field auditor finds that a seller under audit has an existing CUTS determination. When determinations have been issued, these determinations or demand billings cannot be routinely canceled. If there is a discrepancy in the amount of determination, the auditor should advise CUTS by memorandum of the proper measure upon which the billing should be based. The key exception is if the transaction is subject to sales tax. The CUTS staff should be contacted to resolve the issue.

In instances where a determination has not been issued, CUTS staff will provide the auditor with information so that the account may be properly audited.

REGULAR SALES OF NEW AND USED CARS

0607.00

GENERAL

0607.05

As indicated (Section 0603.10), certain adjustments to recorded sales figures usually will be required in establishing audited total sales. Sections 0607.10 to 0607.25 provide information relative to DMV requirements and use of DMV Reports of Sale. The remaining sections cover many items encountered most frequently and provide background information. See section 0616.00 for information regarding the Lemon Law.

MOTOR VEHICLE DEALER TAX LIABILITY

0607.07

When a vehicle is sold by a person other than a licensed vehicle dealer, the applicable tax is generally the use tax, which the purchaser pays directly to the DMV at the time the vehicle is registered. However, when a vehicle is sold by a licensed dealer, the applicable tax is sales tax. As with other sales tax transactions, the sales tax is imposed upon the retailer, who may collect sales tax reimbursement from their customer.

There are instances where the person who holds a DMV dealer's license is not the same as the person holding the seller's permit. In such cases, the auditor must verify if the seller's permit holder is actively using the dealer's license to conduct business operations. Although the dealer's license is held in the name of another person, the CDTFA will regard a seller's permit holder who is actively using another person's DMV dealer's license to conduct business as the person licensed under the Vehicle Code as a dealer. By using the dealer's license of another person, the seller's permit holder is liable for the sales tax on vehicle sales pursuant to RTC section 6275(b).

As RTC section 6275(b) indicates, the person holding the dealer's license is liable for sales tax on vehicle sales made using his or her dealer's license; therefore, auditors should issue a dual determination in the name of the licensed vehicle dealer in addition to the seller's permit holder.

VEHICLE CODE

0607.10

Three provisions of the Vehicle Code of the State of California important to the auditor are:

- a. Requirements for the registration of vehicles.
- b. Conditions under which dealers must report sales to DMV.
- c. Conditions under which lessor-retailers are required to pay sales tax on retail sales of vehicles.

Section 4000 of the Vehicle Code defines vehicles subject to registration with DMV and includes: "... motor vehicle, trailer, semi-trailer, pole or pipe dolly, logging dolly, or auxiliary dolly ..." This includes all types of automobiles, buses, motorcycles, trucks, and trailers. Section 5901 of the Vehicle Code requires that dealers or lessor-retailers in both new and used cars report all retail sales to DMV. It reads as follows:

"Every dealer or lessor-retailer, upon transferring by sale, lease or otherwise any vehicle, whether new or used, of a type subject to registration under this code, shall, not later than the end of the fifth calendar day thereafter, not counting the day of sale, give written notice of the transfer to the department at its headquarters upon an appropriate form provided by it."

Section 11615.5 of the Vehicle Code requires a licensed lessor-retailer to pay sales tax with respect to the retail sale of a motor vehicle, except a sale to the lessee of the vehicle, if the lessor-retailer files a Report of Sale with DMV.

DEALER'S REPORTS OF SALE**0607.15**

The Vehicle Code requires that dealers apply for a dealer's certificate of registration and report all sales on appropriate forms, one copy of which is retained by the dealer, and one copy filed with DMV headquarters in Sacramento. These reports contain such information as the dealer's name, address, and registration certificate number, the purchaser's name and address, the make of vehicle sold, the date of sale, and engine number/serial number, body type and model name and number. DMV's copies of these reports of sale are retained for four years.

NEW VEHICLE SALES**0607.20**

In the case of new vehicles, the report form used is "Application For Registration Of New Vehicle" (Reg. 397). The New Vehicle Report of Sale is used for reporting the sale of a new vehicle that the dealer is franchised to sell. Since this form of report also serves as the application for registration, it is virtually impossible for a purchaser to secure registration of a new automobile unless the purchaser signed the dealer's Report of Sale and the dealer has sent that form to DMV. For this reason, there should be a Report of Sale on file at DMV for every new car sold. However, some new car dealers do not comply with the Vehicle Code in that they do not submit a Report of Sale on a unit sold to an out-of-state resident when the vehicle is not to be registered in California.

The New Vehicle Report of Sale forms are made up of four parts. The upper portion of the original is the application copy submitted to DMV for registration of the vehicle. The application copy is to be submitted to DMV with all forms and fees within 20 days of the date of sale. The upper part of the duplicate portion is the dealer's "book copy" and must be retained in the book. The stub of the original is the temporary operating copy which is displayed in the vehicle. The bottom portion of the original is the Purchaser's Temporary Identification that is displayed in the vehicle. The bottom portion of the duplicate is the Dealer's Notice which is to be mailed to DMV no later than the 5th calendar day following the date of sale. The dealer must retain the "book copy" for four years, corresponding with DMV's retention period.

If the Report of Sale is to be voided due to an error, all parts must be marked "VOID." A Report of Sale is required when a California dealer makes a courtesy delivery. (see sections 0608.55, 0608.60 & 0608.65) "Courtesy Delivery" must be marked on both the upper and lower portions of the Report of Sale (original and book copy). Examining the Report of Sale book can identify the courtesy deliveries for the audit period.

When a vehicle is sold for registration out-of-state, a Report of Sale is required and the original is marked "For Registration Out of State." DMV will not allow the vehicle to be moved on a highway without the purchaser securing a One-Trip permit (see section 0611.25) to move the vehicle out of California, or obtaining registration in his or her home state prior to moving the vehicle on the highway. The dealer is responsible for the completion and submission of a Statement of Fact explaining how the vehicle was moved. If a copy of this is filed in the deal jacket, this could be one source for determining the taxability of the transaction.

When dealers sell new vehicles to dealers of the same franchise, they are not required to report the transaction on the Wholesale Report of Sale. The selling dealer submits a Notice of Release of Liability to DMV.

USED VEHICLE SALES

0607.25

In the case of used vehicles, the report form used is “Report Of Sale — Used Vehicle”(Reg. 51). The Used Vehicle Report of Sale is used for reporting retail sales of used vehicles. This form is not to be used to report wholesale transactions. While the Vehicle Code requires the dealer to file such a report for each sale, it is possible to transfer registration into the name of the purchaser without submission of the report. Occasionally, dealers have sought to conceal their connection with the sale of used cars by failing to file a “Report Of Sale — Used Vehicle” and by not inserting their names as required on the reverse side of the Certificate of Ownership (pink slip). Such pink slip transfers indicate passage of title directly from one owner to another. The auditor cannot, therefore, be sure that the records of DMV disclose all sales of used cars by dealers.

The Used Vehicle Report of Sales also consists of four parts: Application Copy (upper portion of original), Book Copy (top of the duplicate), Dealer’s Notice (bottom of the original), and Purchaser’s Temporary Operating Copy (bottom portion of the duplicate). All parts of the Report of Sale have the same control number. The book copy is to be retained by the dealer for a four-year period.

A Wholesale Report of Sale form is used to report sales of used vehicles from dealer to dealer. This includes wholesale transactions to out-of-state or out-of-country dealers, scrap metal processors, and dismantlers. All parts of the Report of Sale have the same control number.

Wholesale motor vehicle auctions prepare a Vehicle Auction Wholesale Report of Sale that may be computer generated by the dealer or ordered through DMV.

DEALER’S REPORT OF SALE AS EVIDENCE

0607.30

The filing of a Dealer’s Report of Sale will be presumptive evidence that the dealer who filed the report made the sale. However, there may be cases where this presumption can be overcome as, for example:

- a. Where a dealer improperly acquires the report book of another dealer and fills in the name of the dealer to whom the book was issued.
- b. Where a dealer sells a car to another dealer and the registration is in the name of the purchasing dealer.
- c. Where a dealer rents a vehicle to a salesman and reports the vehicle as sold in order that it may be registered in the salesman’s name. (See sections (b) & (c) of Regulation 1669, Demo. & Display)
- d. Where a dealer registers a vehicle in the name of the manufacturer. (Section 0608.50)

CUSTOMER DEMANDS CERTIFICATE OF TITLE

0607.32

When a purchaser demands title for a vehicle which has been purchased free of any liens or encumbrances, the dealer is required to complete a used vehicle Report of Sale in the usual manner. The used vehicle Report of Sale number is entered on the back of the Certificate of Title and title is delivered to the purchaser including a smog certification, if applicable.

In such “demand title” transactions, the dealer is required to obtain a Statement of Fact from the purchaser confirming his or her demand for and receipt of title indicating the reason for the demand. Most often the reasons given are “will be registered out-of-state” or “wish to personally take care of transfer.” In either case, delivery of vehicle to a consumer in California will generally make this a taxable transaction for the car dealer. The dealer is still considered the retailer of the vehicle and responsible for the sales tax, regardless of a “demand title” clause.

USE OF DEALER'S REPORTS OF SALE IN AUDITING GROSS RECEIPTS

0607.35

It is apparent from the preceding sections that an examination of some or all of the dealer's copies of Report of Sale (ROS) books can be of great value in auditing a dealer's records. In the examination, notations of self-registrations, sales to leasing companies, sales to out-of-state residents, and registration to other dealers should be made for reference in auditing self-consumed merchandise and deductions.

The auditor should verify that all ROS books are available and have been accounted for in the taxpayer's records. Occasionally, the dealer's ROS books may not be available and must be obtained from DMV by the auditor. This may occur when DMV has secured the ROS books for audit or the dealer has ceased operations. In new car dealer audits, the information should be obtained from DMV only when poor records, loose internal control or other special circumstances warrant.

Vehicle dealer information, including ROS and Administrative Service Fee Report information, may be obtained from the DMV either by emailing the request to LODInfoReq@dmv.ca.gov or by calling the DMV's Occupational Licensing Information Service Voicemail at (916) 229-3151. Auditors are encouraged to request information by email instead of telephone. Email allows an electronic record of such requests to be retained by CDTFA which should facilitate follow up requests, if necessary.

Auditors must provide the following information to DMV:

- Auditor's name
- Auditor's contact phone number
- Office mailing address
- CDTFA's DMV requester code
- Name and dealer's license number of the party for which information is being requested
- Specific information being requested
- Business reason for the request

Auditors should allow 7 – 10 business days for processing the requested information. DMV will provide the requested information via US Postal Service. To follow up on a request, the auditor may call the DMV at (916) 229-3127. Whether or not utilized in the audit, the information obtained from the DMV must be included in the audit working papers.

USE OF REPORTS OF SALE IN AUDITING USED CAR DEALERS

As noted in previous sections, used car dealers use the "Reports of Sale – Used Vehicle" (ROS) form to register used vehicles with the DMV. Auditors reconcile a used car dealer's ROS to verify reported taxable sales. The ROS is required to be filed with DMV on all retail used vehicle transactions. Thus, accounting for the ROS that DMV issued to a dealer is an important verification step when there is doubt about the accuracy of a dealer's reported sales.

The DMV, Occupational Licensing Branch, maintains an inventory of each ROS number issued to car dealers; however, the DMV does not maintain the ROS number after processing the registration. Since this information is not maintained, there is not a readily available way to compare a used car dealer's actual use of ROS with actual registrations to determine the number of unused ROS. Comparing the number of ROS issued to a dealer with the number of vehicle sales recorded in the dealer's records, plus the number on-hand, plus the number of "voids," and then considering the "missing" difference to be sales of vehicles is not necessarily accurate.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

USE OF DEALER'S REPORTS OF SALE IN AUDITING

GROSS RECEIPTS

(CONT.) 0607.35

In such cases, additional or secondary audit techniques must be used and clearly documented as part of the audit report to support an estimated tax liability established by projecting the number of missing ROS forms. Audit Manual section 0407.05, *Specialized Techniques – Sales and Use Tax General*, provides other techniques the auditor may use to support the liability. These include: investigating bank deposits; gross profit and net worth analysis; income tax returns; or purchases plus a mark-up. Auditors should also consider touring the location of the business to ascertain whether the amounts being reported are reflective of the size of the business. One or more of these additional techniques must be used to support whether the missing ROS are in fact sales of used vehicles.

DMV SALES DATA

0607.37

DAS maintains a database from DMV of vehicles registered by licensed dealers. The database contains the vehicle registration information by dealer number and provides the following:

- VIN (Vehicle Identification Number)
- License Plate
- Registered Owner
- Registered Owner's City
- Legal Owner (Lienholder)
- Legal Owner's Address
- Vehicle Registration Date
- Odometer Reading Date
- Transfer Date
- Vehicle Make, Type, Year
- Odometer Reading
- VLF (Vehicle License Fee) Code

DAS estimates the sale date by using odometer reading date or transfer date. Sales price is estimated by using the VLF measure. VLF measure is determined by the VLF Code on the vehicle registration and it is usually within \$199 of the actual selling price. The maximum measure used is \$96,400.

Some data errors should be expected since the vehicle registration data are keyed in by hand. DMV data can be validated by Consumer Use Tax Section (CUTS) and bill of sale and report of sale documents can be provided as needed. Your request should be sent via e-mail to CUTS DMV Search for D/O Audits. See AM section 0606.15 for more information on requesting DMV information from CUTS.

DMV Data requests should be sent to DAS via email to DataReq@cdtfa.ca.gov with "DMV Data" in the subject line.

CLEAN DEALS TEST

0607.40

Reference has been made to dealers who fail to submit Reports of Sale. It is often difficult to detect such practice but there are several ways in which this can be done depending upon the exact circumstances. The so-called "clean deals" test may be employed. This test simply consists of determining the percentage of clean deals (i.e., cases in which a purchaser buys a new car without trading in an old one) compared with the total car sales.

FORM CDTFA-543, CLEAN DEAL QUESTIONNAIRE**0607.42**

Form CDTFA-543, is a questionnaire directed to the purchaser of a vehicle. *Form CDTFA-543 should be used with discretion and only in those instances where an audit supervisor feels that information obtained directly from motor vehicle purchasers might be of substantial value in ascertaining whether either a dealer or a salesperson has incurred unreported tax liability.* The letter is to be directed to selected purchasers and should, wherever possible, include a description of the car. It should be mailed with an addressed and stamped envelope and should bear the dealer's permit number (not name) for identification purposes. Only one copy needs to be prepared since a control record can be maintained by appropriate notations on working paper schedules.

EXAMINATION OF SALES JOURNALS**0607.45**

- a. **NEW CAR RETAIL.** The standard journals prescribed by the manufacturers are usually printed with account titles and account numbers. Most sales journals are set up to automatically update their corresponding cost and inventory account. They are self-explanatory following examination of the general ledger accounts. The general composition should be examined with particular attention to postings to the general ledger, credit postings to expense accounts for a portion of the new car selling price or credit against new inventory cost of sales indicating existence of underallowance, and debit entries to sales accounts.
- b. **NEW CAR FLEET.** Postings are also from new car vehicle contracts or deal jackets, but the sales are to leasing companies and purchasers who buy in quantity at a special discount. Generally, customer (lessee) names are entered in this journal. It is necessary to trace entries to other sources such as deal jackets, vehicle contracts or sales tax worksheets to determine if the sale was made to a leasing company. The considerations are the same as for "New Car Retail." Some dealers may not maintain a separate fleet sales journal and leasing transactions may be located in the new car journal. Dealers with large in-house rental department may maintain a lease and rental journal.
- c. **NEW COMMERCIAL.** Postings are from new car invoices in the same numbered series as passenger cars, or from a separate series of invoices devoted solely to commercial vehicles. In addition to the considerations noted in the foregoing paragraphs, special attention must be given to the manner of handling special bodies. Often, the special bodies are by separate contract and the systems for controlling such sales vary.
- d. **USED CARS.** The sales contained in this journal cover used cars- retail, used cars- wholesale, used trucks- retail, used trucks- wholesale and sales of repossessions. Postings are based on used car vehicle contracts or deal jackets.. Again, aside from general composition of the journal, particular attention should be paid to general ledger postings and debits to sales accounts. In addition, the auditor should be alert for discount accounts and combination of both wholesale and retail sales in the single column of repossessions. In scanning sales, the auditor should take note of the margins of profit on used car - retail sales, since abnormally high margins are indications of deflating trade-ins.
- e. **PARTS, ACCESSORIES AND SERVICE JOURNAL.** This journal is a summary of repair orders and counter sales invoices as recorded in the daily sales summary. It must be scanned for the combining of taxable and non-taxable sales in posting. Some dealers add small charges to repair orders for supplies used and credit this amount to expense accounts rather than to a taxable sales account.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

- f. **INTERNAL.** The composition of the journal has the characteristics of both the service and parts journal, and postings to this book of original entry are from internal repair orders and sales invoices. This journal is peculiar to automobile accounting and is a means for the selling department to apportion its cost of doing business to another department within the dealership. Sales to consumers should never be entered in this record. Indications of self-consumption are noted in this record by examination of debits to company car and demonstrator expense accounts. The bulk of the entries will reflect parts withdrawn from parts department and labor from the service department in connection with work done on vehicles held for sale.

VEHICLE CONTRACT DATA

0607.50

This section is concerned only with vehicle contracts. Invoices on repair orders are discussed under labor in section 0612.00. Invoices on parts and accessories are discussed in section 0609.30. The extent of examination of vehicle contracts is determined by the volume of sales, number of contracts, and indications of discrepancies from sales tax working papers, sales tax accrual account, or other sources.

Vehicle contracts are usually filed in alphabetical order by customer name and sales figures are transcribed to deal jackets that contain preprinted account numbers. The figures from the deal jacket are posted to the sale journal. Stock numbers are usually assigned in numerical sequence to new, used and repossessed units acquired. A used unit accepted in trade on the sale of a new unit is often assigned the same stock number as the new unit sold, but followed, for example, by the letter "A." A used unit accepted in trade on the sale of another used unit is often assigned the same stock number as the used unit sold, but followed, for example, by the letter "B."

Examination of the face of the vehicle contract should be made for content, and comparison of content with posting data on the deal jacket and tracing to the sales journal. Particular attention must be paid to voided contracts and the use of the contracts as credit memos.

EXAMINATION OF CUSTOMER FOLDERS

0607.55

The customer folder is also referred to as car jacket or deal jacket and usually includes a copy of the motor vehicle contract and security agreement or vehicle purchase order, credit application, DMV documents, sales invoice or summary, trade-in information, and other memoranda. The extent of testing will be determined by the volume of sales and the number, nature and measure of any exceptions noted.

The wholesale value given in the current Kelley Blue Book may be used as a guide in determining whether value of the trade-in is the "fair market value." The wholesale value is defined as the "average cash value of a clean car fully reconditioned." In many instances a dealer will allow the wholesale "Blue Book" less costs of reconditioning which is a "fair market value." Information pertaining to underallowances is included in section 0607.60.

Although this scenario is not likely, particular attention must be given to the comparison of purchase order and vehicle contract in those dealerships where the customer is not furnished a copy of the contract.

The status of the conditional sales contract as a controlling document has been recognized by legislation through the Rees — Levering Motor Vehicle Sales Finance Act. It requires that all aspects of agreements between the buyer and seller of a motor vehicle be contained in a single conditional sales contract. It also required that the contract set forth as a separate item the cash price of the motor vehicle described in the conditional sales contract.

UNDERALLOWANCES ON TRADE-INS

When a vehicle is traded-in on a purchase of a new vehicle, the measure of tax on the new vehicle includes the amount agreed upon between the seller and buyer as allowance for the vehicle traded-in pursuant to Regulation 1654(b)(1). The regulation further notes that when the CDTFA finds that the allowance is less than the fair market value, it shall be presumed that the allowance was such market value. Therefore, the fair market value of the new vehicle sold should not be redetermined merely because the trade-in allowance was below the price listed in the Kelley Blue Book, as long as the underallowance was a result of a bonafide transaction between the buyer and seller.

An auditor may rebut the presumption provided in Regulation 1654(b)(1) that the agreed value of the trade-in represents the fair market value if there is sufficient evidence to establish that the dealer deliberately underallowed the trade-in value to reduce the measure of tax. Under such circumstances, the underallowance is taxed as additional gross receipts and a 25% intent to evade penalty may be appropriate. Intent to evade may be evidenced by:

1. Recorded trade-in allowances that are consistently below market value and that are not attributed to less than fair condition of the trade-in.
2. Gross profit margins that are consistently lower on transactions involving trade-ins than on those without trade-ins and which are not attributed to business practices followed by the industry, such as trades on loss-leader automobiles, or trades during promotional sales.
3. A widespread pattern of underallowances occurring consistently throughout the audit period.

If an underallowance is an isolated transaction or if found in a small number of transactions, further examination is necessary to determine whether the difference in trade-in value and the fair market value listed in the Kelly Blue Book is attributable to the condition of the vehicle, making the underallowance not taxable. However, if the dealer deliberately underallowed the trade-in value to reduce the measure of tax, the underallowance should be taxed as additional gross receipts and an intent to evade penalty may be appropriate.

Occasional instances of underallowances are generally not of sufficient tax consequence to warrant the audit time required to substantiate them. However, this should not prevent the assessment of tax on any underallowance even if a pattern is not present, if the amount involved is substantial, can readily be determined, and the evidence fully supports assessment of the lone transaction. For example, assume that in an audit of a Jaguar dealer, it is discovered that in the sale of a Jaguar for \$80,000 that a Mercedes is taken as a trade and valued at \$20,000 in the documents of sale. From an examination of the car jacket information for the Mercedes taken in trade, it is determined that the Mercedes was sold for \$100,000 and its inventory value was set at \$50,000 which was close to the Kelly Blue Book value. While this is an indication that an underallowance may be involved in the sale of the Jaguar by an apparent \$30,000, more information concerning the sale price of the Jaguar needs to be established before recommending any liability based on underallowances; after all, we should not penalize a dealer for making a good deal. Accordingly, if similarly equipped Jaguars are sold for around the same sales price (\$80,000), the evidence would seem to indicate that no liability should be established due to the underallowance. However, if information indicates that similarly equipped Jaguars are sold for \$110,000, then the \$30,000 underallowance should be considered as additional gross receipts and a tax liability established accordingly.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

UNDERALLOWANCES ON TRADE-INS

(CONT. 1) 0607.60

In determining fair market value, Kelley Blue Books may be used as a guide. However, it should be carefully noted that the wholesale values provided by this reference are average values for clean, fully reconditioned automobiles. The auditor should be alert to trade-ins which do not meet this definition. A below average trade-in allowance for an automobile in poor condition should not be treated as an underallowance. The subsequent sale of a trade-in at a less than normal price, expenses incurred by the dealer to repair or recondition the trade-in, may indicate that the automobile traded-in was not in average condition.

In auditing for underallowances, the first step would be to examine the new car sales journal and look for trade-ins with a credit to new car cost of sales. Normally, new car cost of sales is not credited in a new car sale posting. Tracing the transaction to the deal jacket could provide more information on the trade-in. For example, the actual cash value of the trade-in is \$8,000 and the dealer allows a trade-in allowance of \$5,000, crediting the difference to new vehicle cost of sales. The sales journal entries could be recorded by the dealer in the following manner:

New Car Sales Journal 10

Control #	Account #	Name of Account	Amount	Profit
	231Y	New Car Inventory Units	(1)	
	417	New Car Retail	(\$23,001)	
	417X	Units New Car Retail	1	
	617	Cost of Sales New Car Retail	\$24,303	
70410	231B	New Car Inventory	(\$24,303)	
	324	Sales Tax Accrued	(\$1,898)	
70410	302	DMV Fees	(\$560)	
70410	304	Warranty Insurance	(\$500)	
70410	210	Notes Receivable Customer	\$20,959	
	240X	Units Used Car	1	
70410A	240	Used Car Inventory	\$8,000	
	617	Cost of Sales New Car Retail	(\$3,000)	\$1,698

The control # refers to stock number of the vehicle. The vehicle contract shows a trade-in allowance of \$5,000. However, the trade-in is posted to the used car inventory at the actual cash value of \$8,000 as determined from the Kelley Blue Book wholesale value. Crediting new car cost of sale to balance the entry is called "grossing up the deal."

Other methods of recording the transaction include posting directly into an underallowance or other general ledger account, or adjusting inventory values in the general journal.

OVERALLOWANCES TAKEN AS DISCOUNTS

0607.65

Some instances may be found where dealers net from gross sales, or claim as a cash discount on their return, amounts allowed on used car trade-ins in excess of actual value of the trade-in. These excess amounts are known in the trade as overallowances. Such overallowances are not deductible as discounts. An example of a transaction of this nature is illustrated below:

Manufacturers list price is \$20,000

Trade-in has a value of \$5,000

	Correct Computation	Incorrect Computation
Price of car:	\$20,000	\$20,000
Sales Tax (@ 8.25%)	1,650	1,568
License:	400	400
	\$22,050	\$21,968
Trade-in Allowance:	6,050	4,968
Discount:	n/a	1,000
Balance:	\$16,000	\$16,000
		(\$19,000 x 8.25%)

The correct measure of tax is \$20,000.

DISCOUNTS

0607.70

Virtually all new car dealers allow a discount on new vehicle sales. The amount of discount on any sale will be reflected on the documents of sale, and recorded in the sales journal as a discount. Discounts are netted from gross sales on the financial statements, either by decreasing sales or by showing the amounts of discounts as minus amounts on the statements. New car dealers will vary in their method of handling the discounts for reporting purposes. Some will segregate those amounts which are not valid discounts and add them to total sales, while others will add the total discounts to total sales and claim a deduction for the valid discounts. The mechanics of handling the discounts per the general ledger will be clear from the financial statements and sales tax working papers.

The auditor is more concerned with establishing the validity of the recorded discounts. The examination of the car journals and the reconciliation of the sales tax accrual account usually will disclose a dealer's practice of charging tax on the gross amount before discount. The more common practice, which is not apparent from the formal records, in mishandling discounts is the lack of agreement of documents. The wide range of errors that can occur with discounts is illustrated in the following examples.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

DISCOUNTS

(CONT. 1) 0607.70

Example 1 — Tax On Gross

Situation: Recorded and reported amounts are based on the vehicle contract and discount of \$1,000 claimed or netted. Reported measure of tax is \$19,000.

Selling Price	\$20,000
Sales Tax (@8.25%)	1,650
License	400
TOTAL	<u>\$22,050</u>

Settlement:

Discount	1,000
Down Payment	1,000
Contract in Transit/Proceeds	\$20,050
TOTAL	<u>\$22,050</u>

DISCUSSION: Discount is not allowable since tax was computed on the gross selling price.

Example 2 — Inflated Contract

Situation: Recorded and reported amounts are based on the actual deal and discount of \$1,000 claimed or netted. Reported measure of tax is \$19,000. Proceeds from contract coincide with contract in transit. Selling price, tax, license and down payment were inflated on the contract in order to obtain lending institution acceptance.

	Inflated Contract	Actual Deal
Selling Price	\$23,000	\$20,000
Sales Tax (@8.25%)	1,898	1,650
License	460	400
TOTAL	<u>\$25,358</u>	<u>\$22,050</u>

Settlement:

	Inflated Contract	Actual Deal
Discount	1,000	1,000
Down Payment	5,358	2,050
Contract in Transit/Proceeds	19,000	19,000
TOTAL	<u>\$25,358</u>	<u>\$22,050</u>

DISCUSSION: The discount is not a factor for consideration. The contract is the final document indicating agreement of the parties, and since sales tax reimbursement is computed on the inflated amount, tax of \$1,898 is due. The measure of tax is \$23,000.

Example 3 — Inflated Contract

Situation: Recorded and reported amounts are based on the sales invoice, and discount of \$1,000 claimed or netted. Reported measure of tax is \$19,000. Proceeds from the contract coincide with contract in transit. Selling price per contract includes tax and license, and contract was inflated to obtain financing.

	Actual Transaction	Inflated Contract
Selling Price	\$20,000	\$24,000
Sales Tax (@8.25%)	1,650	
License	400	
TOTAL	<u>\$22,050</u>	<u>\$24,000</u>
Settlement:		
Discount	1,000	1,000
Down Payment	2,050	4,000
Contract in Transit/Proceeds	19,000	19,000
TOTAL	<u>\$22,050</u>	<u>\$24,000</u>

DISCOUNTS

(CONT. 2) 0607.70

DISCUSSION: In the absence of a separate statement of tax reimbursement and license on the contract, it is assumed that the gross amount includes both and the measure of tax is computed as follows:

Gross	\$24,000
Less: License Fee	400
Net	\$23,600
Less: Sales Tax Included (@ 8.25%)	1,799
Audited Selling Price	\$21,801

Example 4 — Tax Included in Discount

Situation: Recorded amounts are based on the figures posted on the deal jacket. Reported Measure of tax is \$19,076 (21,650–1,000)/1.0825. The vehicle contract notes that sales tax is included at 7.62%.

Selling Price	\$20,000
Sales Tax	1,650
License	400
TOTAL	\$22,050

Settlement:

Discount (Incl. Sales tax @ 7.62%)	1,000
Down Payment	2,050
Contract in Transit/Proceeds	\$19,000
TOTAL	\$22,050

DISCUSSION: The agreement of the parties reflects sales tax included in the discount on the vehicle contract. The proper measure of tax has been reported, regardless of the fact that recorded amounts do not reflect adjustments of tax accrual and discounts.

It should be noted that discounts, e.g., cash rebates given by a dealer to a customer in cash or as credit on the financing contract, or as a reduction in the selling price of the property, are not part of the dealer's gross receipts.

When sales tax reimbursement is computed on an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the dealer, the amount paid is excess tax reimbursement as defined in Regulation 1700(b). When the auditor ascertains that excess tax reimbursement was collected, the dealer will be afforded an opportunity to refund the excess collections to the customer. In event of failure or refusal of the person to make such refunds, the excess tax reimbursement must be paid to the state. In all cases, the auditor should encourage the dealer to refund the erroneously charged excess tax reimbursement. (See section 0417.00)

REBATES

0607.72

A **manufacturer's rebate** is an allowance made by the manufacturer directly to a consumer as an incentive to purchase the manufacturer's vehicle from a dealer. The rebate may be paid to the dealer, who in turn pays it to the customer, or it may be paid directly to the customer. Manufacturer rebates are considered part of taxable gross receipts, even if the customer assigns the rebate to the dealer as down payment.

Under a **factory-dealer incentive**, the manufacturer sells the vehicle to the dealer at a discounted price to promote the sale of the vehicle. The dealer, in turn, is able to sell the car to the customer at a lower price. The amount of discount received by the dealer is not subject to tax. Tax is based on the selling price of the vehicle to the customer.

RETURNED MERCHANDISE — RESCINDED SALES

0607.75

A “roll back” is a vehicle purchased and operated on a Report of Sale and returned to the dealer (credit unavailable, customer changed mind, etc.) prior to completion of the transaction and issuance of the title. Since all fees, including transfer fees, are due to DMV, a dealer should not void the Report of Sale. A subsequent sale of a new vehicle roll back will require a Used Vehicle Report of Sale to the second buyer along with application for Original Registration listing the second buyer as registered owner. In case of a used vehicle roll back, there will be two Used Vehicle Report of Sale: one from the first buyer and one for the second buyer, and a Statement to Record Ownership in the name of the second buyer.

The accounting systems provide specific means for canceling sales or recording returns of merchandise already recorded in the various sales journals. New and used car dealers will follow one of the following methods discussed below.

One method is a direct entry reversing the original transaction can be made in the sales journal.

Another method which might be employed would be by a journal entry. The auditor would ordinarily examine these journal entries with deviations from prescribed procedures becoming readily apparent.

A method occasionally employed by used car dealers is the lining out of the entry in the sales journal, especially if the return or cancellation is within the reporting period of the original sale.

Since the posting from the sales journal will be net of rollbacks as well as lined-out entries, the auditor must establish the amounts netted as being valid exclusions from taxable sales.

Occasionally, a vehicle originally sold by a dealer will be taken in trade on another sale within a short time after the first sale and the dealer will enter the trade as a roll back.

Some dealers will roll back vehicles repossessed within a short period of time after sale, especially if is voluntary on the part of the customer.

In each case, the auditor should examine the customer’s folder for receipts for refund of down payments, return of trade-in, and for various correspondence, memos, notes, charges, etc., which could give clues as to the validity of the deduction. Sometimes the dealer returns the purchase price and the sales tax, but may not return the registration or license fees to the buyer. Since all fees are due to DMV within 20 days of the date of sale, the dealer is regarded as returning the full price of the vehicle. License and registration fees are not considered to be part of the sales price of the vehicle for sales tax purposes.

LICENSE FEES AND IN LIEU TAXES

0607.80

The Vehicle License Fee Law imposes a license fee for the privilege of operating in this state any vehicle of a type subject to registration under the Vehicle Code. This license fee, and the tax, in lieu of personal property tax, must be paid before plates will be issued for a new car or before current year plates will be issued for used cars equipped with prior year plates.

In Connection With New Cars

The new car dealer, as a practical matter, may collect the amount of the license fee and in lieu tax involved and remit it to the DMV. In such cases, the dealer is merely accommodating the purchaser in remitting the fee, and the sales or use tax does not apply to the amount of fees paid by the dealer. If the amount collected from the purchaser exceeds the amount required to be remitted to DMV, excess fees collected are to be included in the additional measure of tax. The auditor should, therefore, examine the “License Fees” account in the general ledger for unreported taxable license fees collected.

LICENSE FEES AND IN LIEU TAXES

(CONT) 0607.80

In Connection With Used Cars

In the case of used cars as well as new cars registered in the dealer's own name, license fees and in lieu tax paid by the dealer to the DMV prior to the time of sale are not a part of taxable gross receipts when added to the selling price of the vehicle under sections 6011 and 6012 of the Sales and Use Tax Law. *(This exclusion does not apply to trailers, semitrailers, and dollies.)*

Sometimes a dealer will add an amount for "license" to a unit on which the fee was paid by someone else prior to the dealer acquiring the car. This charge is taxable since the dealer did not pay the fee to the DMV. Only when a used car is licensed by the dealer can the license fee be deducted from taxable sales when it is stated as a separate item to the customer.

DOCUMENTARY FEES

0607.82

A dealer may charge a document preparation service fee (doc fee) for the preparation of documents in connection with the sale of a vehicle, such as transfer papers required by the DMV. This fee is charged at the dealer's discretion and is neither required nor collected by DMV. The fee may be preprinted on the car purchase order, vehicle contract, or added by the automobile dealer. These charges are taxable as part of the selling price of the vehicle on which tax is computed and it is unlawful to represent this charge as a governmental fee.

SMOG CERTIFICATION FEES

0607.83

The Department of Consumer Affairs is required to make or authorize certain motor vehicle pollution emission inspections, and by statute is required to charge a certificate fee (currently \$8.25) for the inspection. With each application to DMV for initial registration or transfer of registration of certain motor vehicles, a dealer must also transmit a valid pollution control (smog) device certificate of compliance. This charge is not subject to tax as long as it is separately stated and paid to the state by the dealer. If the dealer charges the purchaser for transmitting this certificate, that charge is subject to tax.

Other charges for smog check (such as inspection charges) in excess of the certificate fee are taxable if the smog check is done for a vehicle that the dealer plans to sell. Smog fees in excess of the certification charge that are not related to a retail sale are not subject to tax.

Effective July 1, 1994, purchasers of new vehicles or of commercial vehicles have the option to defer their first smog certification renewal to four years, from the current two years, by paying an additional \$39 at the time of the initial purchase. The Smog Biennial Exemption fee is imposed by the state and not subject to tax as long as separately stated on the sales contract and paid to the state by the dealer.

OTHER CHARGES

0607.84

Dealer Installed Extras. These include accessories such as radios, heaters, air conditioning units, trailer hitches, etc. made prior to delivery of the vehicle to the customer. The charges for these dealer installed extras, including installation labor, are subject to tax.

Federal Excise Tax. A federal excise tax imposed on retail sales is not subject to tax.

Financing, Interest, and Insurance Charges. Separately stated charges for financing, interest and insurance are not subject to tax.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

OTHER CHARGES

(CONT.) 0607.84

Vehicle Registration Service Fees. Under the Business Partner Automation Program, the Department of Motor Vehicles has partnered with vehicle dealers to facilitate the processing of vehicle registration and licensing by electronic means. The dealer will process registration transactions, print registration cards, and issue license plate stickers. Starting January 1, 2004, the maximum amount that the dealer may charge for these services is \$28.00 (\$25 maximum customer fee and \$3 transaction fee). These services are optional. In lieu of these services, the customer may demand in writing the certificate of ownership of the vehicle from the dealer (Vehicle Code §5753, subdivision(b)). Therefore, the \$25 customer fee and the \$3 transaction fee, if separately stated, are not included in the measure of tax. This exemption applies also to registration renewals. (Vehicle Code §1685).

Contract Cancellation Option for a Used Motor Vehicle. On or after July 1, 2006, used motor vehicle dealers are required to offer a two-day contract cancellation option to purchasers of used vehicles under \$40,000. This agreement allows the purchaser to return the vehicle without cause. Tax does not apply to the charge for the contract cancellation option or the portion of the sales price returned to the purchaser. Vehicle Code section 11713.21 limits the amounts that dealers may charge for both the contract cancellation option and the restocking fee for a returned vehicle. The maximum price is based on the cash price of the vehicle. Refer to Regulation 1566, *Automobile and Sales Representative*, and Regulation 1655, *Returns, Defects and Replacements*.

LUBE BOOKS

0607.85

When lube book charges have been included in the selling price of a new car on which tax has been computed, the auditor will include such charges in audited total sales.

When the lube books are sold ex-tax, the method of handling redemption of the coupons will be determined in the examination of repair orders to establish liability, if any, for grease.

UNDERSEAL AND PORCELAINIZE

0607.90

Amounts of sales for underseal and porcelainize vary, and in many dealerships, are non-existent. One of two methods of recording the sales in the new car journal is usually employed: the first being a credit to an inventory account, and the second a credit to labor or sublet repair sales. *If these charges are part of the new car selling price the charge is subject to tax.*

DELIVERY CHARGES

0607.95

The majority of dealers do not make separate charges for delivery. When made, the charges usually are nominal and must be examined for compliance with the provisions of Regulation 1628, *Transportation Charges*.

ESCROW FEES ON MOBILE HOMES

0607.98

Separately stated escrow fees on the sale or purchase of a new or used mobile home shall be excluded from the terms "gross receipts" and "sales price" for sale and use tax purposes.

OTHER SALES OF NEW AND USED VEHICLES**0608.00****SALES OF COMPANY CARS AND SERVICE CARS****0608.05**

The method of recording sales of company cars and service cars varies. The fact that the unit is sold is, of course, determined from the credits to the respective asset accounts. In some cases, the sale is recorded by general journal entry, and in others the sale is invoiced and entered in the sales journal. The car may be transferred to new or used car inventory, and the sale recorded as a routine sale.

The method employed should be clear after examination of the general ledger accounts and sales tax working papers.

SALES OF REPOSSESSIONS**0608.10**

Repossessions are divided into two categories, voluntary and involuntary. The latter are more common and are usually reflected in the dealer's books as inventory items with a balancing debit entry to the disbursement of money to the lending institution. Examinations of general ledger accounts and used car journals establish the proper handling of involuntary repossessions. There is a gap, however, that must be recognized by the auditor. That is, a time lag often exists between the time of repossession and the demand for payment against the dealer under the recourse provisions of the contract. During this period, the owner may reinstate or refinance the car. Also during this period, the dealer, if the car is on the premises, will attempt to negotiate a sale if reinstatement is not effected. In the event a sale can be arranged before the demand payment is due, the dealer may treat the transaction as a transfer of equity or write a new contract with the proceeds applying against the demand amount.

The voluntary repossession results when the original purchaser voluntarily presents the car to the dealer, without the knowledge of the lending institution. This allows the dealer time to secure a buyer before the demand payment is issued.

Audit procedures are parallel to those discussed in transfers of equity and consigned cars. (See sections 0608.15 and 0608.20)

SALES OF SALVAGED VEHICLES BY NON-DEALERS**0608.12**

A *salvage vehicle* is one that has been wrecked or damaged, and the owner, insurance company, financial institution or leasing company considers it too expensive to repair. *For example*, in cases where the insurance company determines the vehicle is a "total loss salvage," it pays the owner the pre-collision value of the vehicle and forwards the certificate of ownership, the license plates and a required fee to the DMV. The DMV then issues a *salvage certificate* for the vehicle. The vehicle may subsequently be repaired and re-registered with the DMV. It is then classified as a "revived salvage" or "salvaged" vehicle.

When a person other than a licensed vehicle dealer sells a vehicle, the applicable tax is generally the use tax, which the purchaser pays directly to the DMV at the time the vehicle is registered. However, in regard to "salvage vehicles," Vehicle Code section 11519 provides that a vehicle with a salvage certificate may not be registered until the vehicle has passed specific safety inspections with the DMV and/or the California Highway Patrol. The sale of a vehicle with a salvage certificate that has not yet passed the required inspections is a sale of "rolling parts" rather than a sale of a vehicle required to be registered under the Vehicle Code. Therefore, the sales tax exemption provided by RTC section 6282 is not applicable and the sale of salvage certificate vehicles may be subject to the sales tax. As with other sales tax transactions, the sales tax is imposed upon the retailer, who may collect sales tax reimbursement from their customer.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SALES OF SALVAGED VEHICLES BY NON-DEALERS

(CONT.) 0608.12

In the event the retailer obtains the necessary safety inspections and obtains a revived salvage title prior to selling the vehicle, the vehicle is a vehicle that is required to be registered under the Vehicle Code. Accordingly, if the seller is not a licensed dealer, the applicable tax is a use tax which the purchaser pays directly to the DMV at the time of registration.

In situations where salvage certificate vehicles are purchased at an auto auction by a non-dealer (retailer) and are subsequently sold to the public, auditors must verify if the retailer is actively collecting and remitting the sales tax on these transactions. If not, auditors must assess the sales tax liability against the retailer of the salvage certificate vehicles, unless the sales are otherwise exempt from sales and use tax (e.g. sales for resale, sales in interstate and foreign commerce, etc.).

The measure of tax on the retailer's retail sale is the separately stated charge for the salvage certificate vehicle, including fees that are a part of the sale (e.g. finders fee, service fee, auction fee, agent fee, representative fee, brokerage fee, etc).

If there is no such separately stated charge, the measure of tax should be established based on:

- Available information on hand (e.g. calculate a mark-up based on available sales and purchase invoices and project the sales of salvage certificate vehicles), or
- Retailer's purchase price of the salvage certificate vehicles at auction plus a mark-up of 10 percent (10%).

CUTS staff is able to obtain copies of DMV documents related to a specific vehicle. Such documents are helpful when details regarding a vehicle are known, including VIN and/or license plate number, but where the sales price of the vehicle is in question. Documents available from DMV may include Registration Receipt, Certificate of Title (pink slip), Bill of Sale, Report of Sale, Statement of Fact, Power of Attorney, and other documents provided to DMV.

Pursuant to Audit Manual (AM) section 0606.15, the documents can be obtained by submitting a request for DMV information by email to *BTFD-CUTS DMV Search for D/O Audits*. When necessary, provide additional information or comments in the body of the email. When the request involves multiple vehicles and/or vessels, the requested information should be submitted in an Excel spreadsheet and sent as an attachment. Auditors should include the following information with their email requests:

- Vehicle Identification Number (VIN) or Vessel Hull Identification Number (HIN)
- Date of Sale
- License plate number or permanent vessel registration (CF) number (if available)

Further, AM section 0606.15 provides that due to the potential volume of requests, these requests should not be made on a routine basis. However, auditors are encouraged to request such DMV documents from CUTS whenever it is needed to resolve an issue with the taxpayer and to complete the audit.

At the time of an audit, the retailer may contend that the purchasers of the salvage certificate vehicles have subsequently paid the tax directly to the DMV on the transactions that the retailer failed to collect and remit the sales tax. In these cases, the retailer should be given an opportunity to establish tax was paid by obtaining a statement from the purchaser utilizing the "XYZ" letter procedure outlined in AM section 0409.51. Forms CDTFA-504-BSV or CDTFA-504-BSV1 (for email response), *Sample "XYZ" Cover Letter for Salvaged Vehicles*, and CDTFA 504-CSV or CDTFA 504-CVS1 (for email response), *Statement Concerning Property Purchased Without Payment of California Sales Tax*, should be used to confirm tax was paid.

TRANSFERS OF EQUITY**0608.15**

A transfer of equity, in the true sense, is a sale between two individuals in which the purchaser assumes the conditional sales contract balance of the seller.

A true transfer of equity, in which the dealer has no function other than the approval of the transferee, results in no additional tax liability to the dealer. If, however, the dealer assists to the extent of displaying the car on the lot, or obtaining the transferee and negotiating the transfer at the dealer's place of business, a sale subject to sales tax has occurred. If the dealer's participation extends only to bringing the two parties together with the negotiations handled by the parties and the lending institution, the dealer has no liability.

The involvement of dealers in these transfers occurs since the dealer wrote the original contract and has future liability on recourse paper in the event of default. A transfer of equity usually arises because the buyer is overextended financially, and the likelihood of repossession is probable. The dealer in order to forestall a repossession may attempt to encourage a transfer of equity.

Evidence of transfers ordinarily will not be found in sales journals or any other formal records. The dealer's reserve statement is the only supporting document reflecting transfers of equity. This statement will show the change in names, but examination of these statements is awkward and not a recommended procedure. Evidence of equity transfers is most likely to be found in a customer folder prepared on the transferee.

WARRANTIES**0608.20**

Pursuant to Regulation 1655(c)(1), a warranty is mandatory if the buyer, as a condition of sale, is required to purchase the warranty from the seller. A warranty is optional when the buyer is not required to purchase the warranty from the seller, but optionally may purchase the warranty for an additional or separately stated charge.

A manufacturer's warranty is defined as a warranty provided by the vehicle manufacturer and sold by a vehicle dealer along with the vehicle. A repairer's warranty is defined as a contract between a vehicle owner and a vehicle dealer or repair shop.

If the vehicle is sold at retail, the mandatory warranty charge is taxable whether separately stated or not. When the manufacturer is obligated to furnish parts under a mandatory warranty, the dealer's charge to the manufacturer is a sale for resale and not subject to tax.

Charges for optional warranties that are separately stated are not subject to tax. Pursuant to Regulation 1655(c)(3), a 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 these items. Thus, when a dealer makes repair work for a manufacturer or third party obligated under an optional warranty, the dealer is making a retail sale of the parts furnished in performing the repairs.

However, if the repair is covered by an optional repairer's warranty, the dealer or repair shop is the end user of the parts. As such, tax is due on the purchase price of the parts when (1) the parts are withdrawn from inventory, or (2) if the parts are specifically purchased for the warranty job, at the time of purchase.

TRANSFERS OF WARRANTIES

0608.25

A transfer of either a mandatory or optional warranty is a transfer of the obligation of the manufacturer to provide replacement parts and/or labor pursuant to the warranty to the new owner in the event that such parts and/or labor are needed and is not a sale of tangible personal property. Warranty transfer fees are therefore not subject to sales tax.

Such a warranty remains in existence and follows the ownership of the automobile until the period of its effectiveness has expired. Parts provided and used after a warranty has been transferred are, for the purpose of the law, purchased at the time of the original sale; and since the warranty applies to the automobile itself, the furnishing of parts pursuant to the warranty, either to the purchaser/owner or to subsequent owners, is not subject to sales tax. The sale of the replacement parts and materials to the seller furnishing them is a sale for resale and not taxable.

DEDUCTIBLES ON WARRANTIES

0608.30

Mandatory Warranties

As explained in 0608.20, tax does not apply to charges for parts used under a mandatory warranty when there is no deductible paid by the customer. The parts are considered sold to the customer as part of the original sale of the vehicle. (When the manufacturer is obligated to furnish parts under a mandatory warranty, the dealer's/repairer's charge to the manufacturer is a sale for resale and not subject to tax.) However if the customer does pay a deductible, tax is due measured by the amount of the deductible allocable to the sale of parts to the customer.

Unless otherwise stated in the warranty contract, when 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. Tax is due on the portion of the deductible that represents the sale of parts. This selling price is calculated based on the ratio of the billed price for the parts to the total billed price (not including tax), before the deductible, and the deductible is multiplied by this ratio.

$$\frac{\text{Charges for Parts}}{\text{Total Charges}} \times \text{Deductible} = \text{Taxable Portion of Deductible}$$

Example 1: A customer is required to pay a \$50 deductible under a manufacturer's mandatory warranty. The repairer bills \$200 for the repair work (not including tax): \$75 for parts and \$125 for the labor. The portion of the deductible amount subject to tax would be computed as follows: $\frac{\$75}{\$200} \times \$50 \text{ deductible} = \18.75 . Assuming a 7.25% tax rate, tax due on the deductible payment equals \$1.36 ($\$18.75 \times 7.25\% \text{ tax rate}$). The total charge for the job, including tax would be \$201.36.

Since the dealer performed the repair under a manufacturer's warranty, the dealer (repairer) would charge \$50 (deductible) to the customer and the balance, \$151.31, to the manufacturer (\$200 parts & labor + \$1.31 sales tax - \$50 deductible).

Note: In this example, there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property. If the warranty contract provided that the customer was liable for tax or tax reimbursement, the repairer would charge the customer \$51.36 and the manufacturer \$150.00.

If a specific payment is made for parts (e.g., a prorated payment is made for a new tire), tax applies to that payment. However, the portion of the deductible payment is taxable only when the charge includes the sale of parts.

Optional Warranties

Optional warranties can be offered by a manufacturer, dealer, or repairer. Unless otherwise stated in the warranty contract, when an optional 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.

Optional dealer or repairer warranties. When the customer is not obligated to pay a deductible, the dealer/repairer is considered the consumer of the repair parts and tax is due based on the purchase price of the parts. If the customer is required to pay a deductible, the repairer is considered the consumer of a portion of the parts and a seller of the remainder. Example 1 provides an example of how to prorate the deductible to determine the selling price of the parts. As the consumer of the parts not sold, the dealer/repairer would owe use tax on the total cost of the parts used on the repair job (assuming the parts are taken from resale inventory) less the cost of the parts sold (taxable portion of the deductible).

Example 2: A customer is required to pay a \$50 deductible under a repairer's optional warranty. The repairer bills \$200 for the repair work (not including tax): \$75 for parts and \$125 for the labor. Parts costing \$45 are pulled from the repairer's resale inventory for the job.

As explained in Example 1, the selling price of the parts (the taxable portion of the deductible) is \$18.75. The cost of those parts is \$11.25 (sales price of total parts \$75 , \$45 cost = 1.667 markup factor; parts sold to customer \$18.75 , 1.667 markup factor = \$11.25.) The repairer would owe use tax on \$33.75 (\$45 total part cost - \$11.25 cost of parts sold) as the consumer of the parts not sold.

Optional manufacturer warranties. The manufacturer is considered the consumer of the repair parts. When a dealer (repairer) does repair work for a manufacturer obligated under an optional warranty the dealer is making a retail sale of the parts to the manufacturer. The dealer is responsible for reporting sales tax on the retail selling price of the parts (cost plus the markup).

Example 3: A customer is required to pay a \$50 deductible under a manufacturer's optional warranty. The dealer (repairer) bills \$200 for the repair work (not including tax): \$75 for parts and \$125 for the labor. Under a manufacturer's optional warranty that requires a customer deductible, sales tax would apply to the full parts charge (\$75 parts X 7.25% tax rate = \$5.44 tax). The total charges for the job would be \$205.44 (\$200 parts/labor + \$5.44 tax). The invoice to the customer would be for the \$50 deductible. The manufacturer would owe the balance of the charges, \$155.44, including \$5.44 in tax.

Note: In this example, there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

EXAMINATION OF FACTORY WARRANTY ACCOUNTS

0608.35

California residents sometimes purchase automobiles from car dealers in neighboring states such as Oregon, Nevada and Arizona. They then license the vehicles out-of-state and return them for use in California without payment of the use tax. Auditors should examine factory warranty accounts of California dealers performing the warranty service on these vehicles as a means of securing information for consumer use tax purposes.

CONSIGNED CARS

0608.40

Consigned cars are usually customers' used cars which the dealer sells on behalf of customers. The car does not become a part of inventory, and the transfer to the buyer is not always effected on a dealer's Report of Sale. In some cases, a consignment agreement is prepared and is the basis for acceptance of an offer and settlement of monies. In the true consignment sale, the dealer has possession of the car and displays the unit with the used car inventory.

Generally, the dealer holds out to the prospective buyer that the car is a part of the dealer's inventory. Therefore, monies received will be reflected in cash receipts, and settlement of account with the consignor will be by credit to accounts receivable in the cash receipts journal or remittance in the cash disbursements journal. Expense of preparing the car for sale will often be reflected by a repair order. If the buyer must finance the car, the contract will be reflected along with the receipt of proceeds.

ACCOMMODATION SALES

0608.45

Accommodation sales differ from consignment sales in that the cars are usually the personal cars of management personnel, salespersons or employees. It is immaterial that the car was displayed at the dealer's place of business. The dealer will be liable for sales tax under Regulation 1566, *Automobile Dealers and Salesmen*, only if one of the following occurred:

- a. The dealer prepared a dealer's Report of Sale.
- b. The dealer executes a conditional sales contract on which the dealer's name appears as seller.

ACCOMMODATION REGISTRATIONS AND DELIVERIES

0608.50

Many automobile manufacturers occasionally request a franchised dealer to receive a vehicle, prepare it for delivery, complete a Dealer's Report of Sale, and deliver the vehicle to the manufacturer's employee or an employee of a subsidiary company. Where the vehicle is registered in the name of the manufacturer or a division thereof, there has been no sale and the manufacturer is liable for use tax on the vehicle cost as indicated in section 0614.07. Where the vehicle is registered to a subsidiary company, the manufacturer is liable for the sales tax measured by the inter-company transfer price. The dealer should be held accountable for the tax on such accommodation deliveries only if it was collected by the dealer.

If accommodation registrations and deliveries as described above are noted during audits of local dealers, the auditor should prepare an audit memorandum, Form CDTF-1164, and forward it to the Out-of-State Field Office. The memorandum should indicate the manufacturer's invoice number, date, vehicle identification number, the purchaser's name as shown on the invoice and as shown on the Dealer's Report of Sale, and whether tax was collected and reported by the dealer.

COURTESY DELIVERIES — FACTORY DIRECTED**0608.55**

A factory directed courtesy delivery is a transaction in which an out-of-state dealer sells a vehicle but directs the manufacturer to deliver the vehicle to the customer at a specified location in California. The manufacturer delivers the vehicle to a local California dealer who redelivers it to the customer. The delivering dealer normally charges the manufacturer for new car preparation but the vehicle is not entered in the dealer's inventory and very often the dealer does not prepare a report of sale.

If the courtesy delivery by the California dealer is made at the direction of a manufacturer who is not a licensed dealer in this state, the California dealer is the retailer of the vehicle under section 6007 of the Revenue and Taxation Code. If the California dealer collects the tax, it is normally recorded in the accrual account. If the California dealer does not collect the tax, a courtesy delivery may easily go undetected. The auditor should ask the taxpayer how the dealership records these transactions in order to save audit time.

Information on courtesy deliveries might be found in one of the following places:

- Separate courtesy delivery folders.
- Customer car folders under either the customer's name or the out-of-state dealer's name.
- Other income posting from any of the journals.
- Separate billing on a miscellaneous invoice.

COURTESY DELIVERIES — FACTORY DIRECTED — FOREIGN SALES **0608.60**

Domestic automobile manufacturers have programs whereby dealers in foreign countries negotiate sales of American-made automobiles to persons wishing to take delivery in California. These vehicles are sold primarily to U.S. Military Service Personnel and State Department employees returning to the United States from overseas assignment. These sales are, for the most part, negotiated at U.S. Military Post Exchanges in foreign countries and the orders are transmitted to the manufacturer's foreign marketing organization for acceptance. The manufacturer is directed to make delivery to the customer at a specified location in California. Tax would apply to this type of transaction.

COURTESY DELIVERIES — NOT FACTORY DIRECTED

0608.65

This type of courtesy delivery involves a delivery from the dealer's inventory to a customer of an out-of-state dealer based on direct correspondence between the respective dealers, and without participation by the manufacturer. The local dealer will invoice the out-of-state dealer for the car. Charges for deliveries in this state to the out-of-state dealer's customers are taxable to the delivering dealer pursuant to Law section 6007.

There is sometimes a question whether the person taking possession of the car in California was a "driver" for the out-of-state dealer or the ultimate customer. In this case, the auditor may request that the out-of-state dealer furnish a copy of the out-of-state registration.

The relief of inventory and charge to the out-of-state dealer is usually effected through the New Car Purchase Journal. Since such credits to inventory are offset against purchases, and the net debit is posted to the general ledger account, no indication of this type of delivery is found during examination of the general ledger. Although a New Vehicle Report of Sale marked "Courtesy Delivery" is required to be prepared, an examination of the DMV Reports of Sale may not disclose all courtesy deliveries since with many of the deliveries, the out-of-state dealer furnishes out of state plates.

A detailed scrutiny of all credits to inventory in the New Car Purchase Journal is therefore necessary. Questioned items should be scheduled. In some instances, invoices for sales to other dealers will be prepared and maintained separately. Examination of such invoices will usually establish that the majority of credits involve trading of cars between recognized dealers in the same locale. These will usually be sales for resale. However, some trades may be questionable, as for example, the transfer of a Chevrolet truck to a Pontiac dealer for use as a parts department truck.

SALES FOR RESALE

0609.00

GENERAL

0609.05

Verification of the deduction "Sales for Resale" should follow the same pattern as for other types of retailers. Resale certificates should be checked and their authenticity established in the usual manner, giving particular attention to isolated and nonrecurring sales which may disclose unauthorized or fraudulent use of resale certificates.

Examination of the various classes of resales to new car dealers, used car dealers, and leasing companies is discussed in the following sections.

NEW CAR REALES

0609.10

There are usually only two types of sales for resale of new cars. They are sales to other new car dealers and to leasing companies. Under the provisions of Regulation 1660, the lessor may give a resale certificate only if the lessor intends to include all the rental receipts in the measure of tax reported. If a vehicle is sold by a franchised dealer to another franchised new vehicle dealer, the first dealer must submit a Notice of Release of Liability. Whenever dealers sell new vehicles to a dealer of the same franchise, they are not required to report the transaction on the Wholesale Report of Sale. For resales to autobrokers see section 0601.50.

RESALES TO LEASING COMPANIES

0609.15

Most new car dealers will sell automobiles to leasing companies for resale. The number of units and the number of leasing companies to whom a dealer sells will vary from a very few companies to several and the number of units from one or two a year to several hundred a year.

The auditor should verify that every leasing company to whom the dealer has made sales for resale has furnished the dealer with a valid resale certificate, and that the certificate indicates all cars purchased are for resale. If the auditor finds that a leasing company is buying both for resale and tax paid at source, all purchase orders from that leasing company should be carefully scrutinized.

The auditor should trace a representative sample of sales for resale to leasing companies to the Dealer's Report of Sale. For purposes of determining the validity of a resale certificate taken by a dealer, the person or persons named on the Dealer's Report of Sale and Application for Original Registration will be considered as the purchaser from the dealer. Unless the person named as the purchaser on the resale certificate is also shown on the Dealer's Report of Sale and Application for Original Registration, either singly or jointly pursuant to Section 4453.5 of the California Vehicle Code, the CDTFA will consider the transaction a retail sale and subject to tax.

Section 4453.5 of the California Vehicle Code permits the registration of vehicles in the names of the lessor and the lessee with their relationships shown as "lessor" and "lessee" in the following manner:

All State Leasing Co., Lessor

Robert J. Murphy, Lessee

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

RESALES TO LEASING COMPANIES

(CONT.) 0609.15

If the joint form of registration is used, it is immaterial if the names are joined by “and” or “or” to the lessor in care of the lessee. If the lessor elects to register the vehicle in this manner, the “care of” must include the designated lessee as follows:

All State Leasing Co.
c/o Robert J. Murphy
or
All-State Leasing Co., Lessor
c/o Robert J. Murphy

If the name of a third person only is shown on the Dealer’s Report of Sale and Application for Original Registration, the transaction will be regarded as subject to sales tax. The name of the third person would appear as:

Robert J. Murphy
or
Robert J. Murphy, Lessee

Lessors who own vehicles registered in the names of lessees only may have the registration changed to show either the lessor or the lessor and lessee relationship on the registration card. Where this is done they may continue to pay tax measured by the rental receipts. Further information on sales of vehicles to leasing companies is included in Regulation 1610, *Vehicles, Vessels, and Aircraft*.

The auditor may find instances where a dealer sells cars to leasing companies for resale but does not register the cars by completing a DMV Application for Registration of New Vehicle. If the dealer has a valid resale certificate from the leasing company, the auditor should prepare Form CDTFA–1164, *Audit Memorandum of Possible Tax Liability*. Further information on Form CDTFA–1164 appears in section 0401.20.

Many new car dealers are now engaged in leasing cars to the general public. The leasing operation is usually by a separate entity, and audits of related accounts will normally be conducted.

NEW CAR RESALES TO USED CAR DEALERS

0609.20

Vehicle Code section 11713.1(f)(1) prohibits a dealer from purchasing a new motor vehicle for resale in a line — make for which the dealer does not hold a franchise.

This violation of the dealer’s license would be cause to disallow acceptance of a resale certificate in good faith. New car dealers should be advised not to accept a resale certificate for this type of transaction. The violation of Vehicle Code section 11713.1 is sufficient to overcome the presumption of a good faith acceptance of a resale certificate, whether or not it contains a statement that the specific vehicle is being purchased for resale in the regular course of business.

A resale certificate may be accepted in good faith from a leasing company that is purchasing a new vehicle to lease. A resale certificate may also be accepted in good faith from a dealer for the following transactions listed in Vehicle Code section 11713.1(f):

- Mobilehomes
- Recreational vehicles as defined in Health and Safety Code section 18010
- Commercial coach as defined in Health and Safety Code section 18001.8
- Off-highway motor vehicles subject to identification as defined in Vehicle Code section 38012
- Commercial vehicles.

An audit memorandum (CDTFA–1164) should be prepared on all sales of new cars by new car dealers, for resale to used car dealers.

USED CAR REALES**0609.25**

Auditors should question dealers' names that they do not recognize, verifying that such dealers exist and that the permit number is correct.

Some dealers may record a retail sale on a "Used Car Wholesale" purchase order filling in a fictitious or legitimate dealer's name and permit number, especially where they have in their possession vehicles on which the "Certificate of Ownership" (pink slip) has been signed in blank. Dealers must pay sales tax on such transactions.

The Wholesale Report of Sale is prepared to report sales of used vehicles from dealer to dealer. This includes wholesale transactions to out-of-state or out-of-country dealers, scrap metal processors, and dismantlers. In case of a wholesale roll back, the buyer must complete a Wholesale Report of Sale back to the selling dealer.

For sales on or after January 1, 1994, a Vehicle Auction Wholesale Report of Sale (REG 398) is required for sale or transfer of a vehicle by a dealer conducting a wholesale motor vehicle auction. These forms may be computer generated or ordered from DMV and include the identity of the vehicle, true mileage, buyer's name, auction's name and number, and the seller's name and signature. In addition to this form, the dealer is still responsible for completing and filing the Wholesale Report of Sale.

PARTS AND ACCESSORIES**0609.30**

New car dealers may be a prime supply source of parts for garages and other auto repairers. In some dealerships, the sales of "Parts-Wholesale" constitute a major portion of the Parts Department operation, while in others this type of transaction is minor or negligible.

These sales for resale are usually generated on counter sales invoices and recorded in the Parts Accessory Journal. Testing of the counter sales invoices must be considered by the auditor based on volume, prior audit findings, and knowledge of the operation.

The auditor must be alert to combined taxable and non-taxable sales in the Parts — Wholesale and Accessories Sales accounts. These types of transactions are not easily detected except by examination of counter sales invoices; however, indications of taxable and non-taxable combinations may be recognized from the sales tax accrual reconciliation. Some dealers will make separate totals of taxable and non-taxable in these mixed accounts.

SALES BY AUTO AUCTIONS AND AUTO DISMANTLERS**0609.40**

Pursuant to RTC section 6092.5, a sale of a mobilehome, commercial coach, or vehicle (including a salvage certificate vehicle) by a licensed auto dismantler, or by any person making such a sale at auction, is presumed to be a sale at retail. The seller may rebut this presumption by accepting a resale certificate in a form as prescribed in Regulation 1566.1 or Form CDTFA-230-F from a licensed dealer, dismantler, automotive repair dealer, or scrap metal processor. The seller is prohibited from accepting a resale certificate for a vehicle, mobilehome, and commercial coach from any purchaser other than those mentioned. (See Regulation 1566.1, *Auto Auctions and Auto Dismantlers*, for additional information.)

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

U.S. GOVERNMENT SALES **0610.00**

U.S. GOVERNMENT PURCHASE ORDERS **0610.05**

The accounting procedures of most instrumentalities of the Federal Government are such that purchase orders are mandatory. The seller is always given more than one copy of the purchase order and these copies are usually found in the customer folder. In the absence of the purchase order, correspondence is usually available which will give sufficient data to establish validity of the deduction.

DISABLED VETERANS' EXEMPTION **0610.10**

Sales of vehicles to disabled veterans may qualify for partial tax exemption. Any amount paid toward the purchase price by the Veterans Administration directly to the seller may be excluded from the measure subject to tax, even though the vehicle is registered in the purchaser's name and all other documents reflect the disabled veteran as the purchaser. The amount paid by the disabled veteran is taxable.

The documentation furnished by the Veterans Administration parallels that of purchases by the U.S. Government. The seller should retain a Government Purchase Order or other documentation supporting direct payment to the seller by the United States.

Verification of the validity of the deduction is readily made by examination of the customer folder.

FEDERAL EXCISE TAX **0610.15**

The federal retail excise tax imposed on the retail sale of heavy trucks and trailers is excluded from the measure of California sales and use tax. The federal tax imposed on the retail sale of such vehicles is therefore not part of the sales price subject to tax whether or not separately stated.

GOVERNMENTAL AGENCIES **0610.20**

Sales tax does not apply to sales to:

- The United States or its unincorporated agencies and instrumentalities.
- Any incorporated agency or instrumentality of the United States wholly owned by either the United States, or by a corporation wholly owned by the United States.
- The American National Red Cross, its chapters and branches.
- Incorporated federal instrumentalities not wholly owned by the United States, unless federal law permits taxing the instrumentality. Examples of incorporated federal instrumentalities exempt from tax are federal reserve banks, federal credit unions, federal land banks, and federal home loan banks.

Copies of government purchase orders or remittance advices should be retained to support claimed exemptions.

SALES IN INTERSTATE AND FOREIGN COMMERCE**0611.00****GENERAL****0611.05**

In verifying sales where delivery is claimed to have been made outside this state, it is usually necessary to review correspondence, factory delivery orders, acknowledgments, DMV Dealer Reports of Sale and other documents.

The CDTFA has developed forms CDTFA-447, *Statement Pursuant to Section 6247 of the CA Sales and Use Tax Law* and CDTFA-448, *Statement of Delivery Outside CA*, for dealer's use in documenting out-of-state delivery. If these statements are properly and fully completed and notarized, the auditor may accept them as the evidence of an out-of-state delivery. However, the use of these forms is not mandatory. The dealer may document and support an exempt sale by means of other satisfactory evidence, such as receipts for meals, lodging, fuel and transportation, and/or statements by the delivering and receiving parties.

The current version of forms CDTFA-447 and CDTFA-448 is published on the CDTFA's website.

FACTORY DELIVERIES AT POINTS OUTSIDE THE STATE**0611.10**

Where a dealer in this state makes a sale to a consumer at a point outside this state, the dealer must retain in the files the necessary data and documents to prove that the car was not sold for use or storage in this state. A substantial number of such sales are factory deliveries. When such sales are made, the California dealer requests the factory or dealer located in another state to deliver a car to:

- a. A consumer residing in this state, or
- b. A consumer residing in another state.

In (a), the California dealer must ordinarily collect use tax. This is particularly true in cases where the purchaser takes California license plates to be placed on the new car. In the absence of evidence to the contrary, the fact that California plates were obtained will be regarded as proof that the car was purchased for use in this state. In (b), the California dealer should retain complete data concerning the transaction. Shipping or delivery orders and any other documents should be retained showing the purchaser's address, the point at which delivery was made, and indicating that the car was purchased for use outside of California.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SALES OF FOREIGN VEHICLES WITH FOREIGN DELIVERY

0611.12

California dealers of foreign manufactured cars often sell them to California residents with delivery being made in Europe and other countries. Exempt transactions should be supported by the same documents as provided in section 0611.05 and 0611.10.

When it is determined that a foreign delivered vehicle has been purchased for use in California, it is necessary to determine who the retailer is for purposes of sections 6203 and 6247. Generally, under European tourist delivery programs where the California dealer acts as an agent for the manufacturer, the manufacturer will be considered the retailer and will be responsible for the collection of use tax if it is registered as a licensed dealer with the Department of Motor Vehicles (DMV). If the manufacturer is not a licensed dealer and the California dealer acts as an agent in the transactions, the purchaser will be liable for the use tax when the vehicle is registered with DMV. Conversely, where the California dealer acts as principal in the transaction, such dealer will be considered the retailer liable for collection of use tax.

Factors which would indicate that the dealer is the retailer include such actions as: taking title to the vehicle, preparing DMV reports of sale, accepting trade-ins on the sale, and/or issuing separate purchase orders to the manufacturer. The amount of tax required to be collected by the retailer in taxable situations constitutes a debt owed by the dealer to this State. An offset maybe allowed for use tax the retailer can establish has been paid by the purchaser to DMV. Therefore, when auditing firms dealing in foreign manufactured automobiles, the auditor should verify any unreported sales of vehicles whose delivery was made at a point outside the United States and question their exemption as sales in interstate or foreign commerce.

INTERSTATE DELIVERIES FROM CALIFORNIA STOCKS

0611.15

Claimed interstate sales from a dealer's California stock usually fall into one of the following categories:

- a. Delivery to a carrier for shipment out of state
- b. Delivery out of state by dealer's employee or agent
- c. Delivery in-state to an out-of-state purchaser or purchaser's agent
- d. Delivery out of state to a known California resident

Under (a), the sale is exempt if delivery is made to a carrier, consigned to an out-of-state point, and actually shipped to the out-of-state point, provided the vehicle was not purchased for use in California. The dealer should retain a copy of the bill of lading to support the deduction and evidence of customer's out-of-state address. The auditor should ascertain who delivered the unit to the carrier, and that the vehicle was not in the possession of the purchaser or the purchaser's agent in this state at any time before the shipment. The use of form CDTFA-448, *Statement of Delivery Outside CA*, is not necessary when the out-of-state delivery is properly supported by a bill of lading or other shipping documents (AM section 0611.05).

INTERSTATE DELIVERIES FROM CALIFORNIA STOCKS**(CONT. 1) 0611.15**

Situations under (b) arise when a dealer is requested to make delivery in a neighboring state. *The transaction is not taxable if the car is actually delivered by an employee acting as agent of the dealer, or by some other individual acting as agent of the dealer.* The fact that the person delivering is in fact the agent of the dealer must be clearly established in each case. Affidavits, reimbursement by the dealer for expenses, or payment of a fee by the dealer are usually sufficient supporting evidence. *In the absence of evidence to the contrary, such a sale cannot be held exempt from tax if California license plates are secured for the delivered car.* The fact that the purchaser accompanied the dealer's agent who drives the vehicle to an out-of-state location does not negate the exemption if the purchaser does not exercise control over the driver or the vehicle. *See AM section 0611.45 for information on sales to military personnel.*

Form CDTFA-448, Statement of Delivery Outside CA, can be used when the vehicle is driven or transported to an out-of-state point by the dealer or the dealer's authorized agent, with the purchaser taking delivery outside California (AM section 0611.05).

Under (c), delivery to a consumer or his/her agent in this state causes the sale of the vehicle to be a taxable transaction. Regardless of the evidence that the vehicle was driven or shipped out of state by the purchaser or purchaser's representative, Sales and Use Tax Law section 6009.1 exemption is not applicable since this is a sales tax transaction (AM section 0635.35). Vehicles in this situation are usually driven out of state on one-trip permits or on plates of another state. The auditor must be alert to deliveries to the purchaser's agent where the dealer represents that the person is the dealer's agent through affidavit or payment of expenses. The person cannot act in a dual capacity as agent of both buyer and seller.

Under (d), Sales and Use Tax Law section 6247 creates a presumption that a sale of a vehicle when a dealer delivers a vehicle outside California to a known California resident, is a sale for use in this state. The purchaser is considered a California resident, for example, if he or she has a California driver's license, or has a California address, even though the purchaser may live in the state only seasonally or intermittently.

Form CDTFA-447, *Statement Pursuant to Section 6247 of the California Sales and Use Tax Law*, is intended to relieve the retailer of the obligation to collect the use tax from purchasers who may be permanent, seasonal, or intermittent residents of California. This statement should be taken at the time of sale, and the original document retained in the retailer's records. This document is needed when the purchaser has a California address and/or a California driver's license or the dealer otherwise is aware that the purchaser is a California resident (AM section 0611.05).

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

BAILEE CLAUSE

0611.20

The auditor may encounter sales by a dealer who has been instructed by the customer to ship or deliver a vehicle to a third person, usually a body builder within the state, as bailee. The customer's purchase order will include instructions not to charge sales tax as the vehicle is to be shipped out-of-state. A "Bailee Clause" may appear on the order.

The mere inclusion of a "Bailee Clause" on an order from a purchaser does not exempt the sale as a sale in interstate commerce. The auditor must determine that the shipment out-of-state by the bailee is properly done in accordance with instructions from the dealer and not the customer. *If the "bailee" is the customer's agent, an exempt sale has not been made.*

ONE-TRIP PERMITS

0611.25

California dealers sell automobiles to non-residents as well as residents, (leasing companies, contractors, and retailers) who intend to register and use the vehicles in another state. When a vehicle is sold for registration out-of-state, the dealer must complete the Report of Sale in full and mark the original "For registration out of state." The purchasers are allowed to transport their cars on their own wheels outside this state without obtaining California plates by securing a "one-trip permit" from DMV or obtaining out-of-state registration before the vehicle is moved on the highway. Even though a one-trip permit is secured in place of registration, this does not relieve dealers of their sales tax liability. Vehicles sold and delivered in California are subject to tax.

Section 4003 (a) of the Vehicle Code provides that a one-trip permit "may be issued by the Department for operating a vehicle while being moved or operated unladen for one continuous trip from a place within this state to another place either within or without this state, or from a place without this state to a place within this state."

Section 4003 also allows the issuance of a quantity of these permits in booklet form upon payment of the proper fee for each permit contained in the booklet. Each permit shall be valid for only one vehicle and for only one continuous trip, and only after a copy describing the vehicle has been forwarded to DMV. There is no restriction as to whom they are issued. Dealers can and do secure them in their own name; however, in those instances where cars are driven from the dealer's place of business to a point outside this State, it will be presumed that title passed to and delivery was taken by the purchaser in this state, for the reason that the dealer would ordinarily use the dealer plates if the dealer drove the unit across the state line. Dealers may overcome this presumption if they are able to furnish documentary evidence that pursuant to the contract of sale the car was delivered to the purchaser outside the state. The dealer is responsible for the completion and submission of a Statement of Fact (Reg 256) explaining how the vehicle was moved. No smog certification is required. Dealer plates may not be used by the customer to take the vehicle out of state.

FOREIGN PURCHASERS**0611.30**

Sales of automobiles to foreign purchasers for shipment abroad, delivered by the dealer to a ship furnished by the purchaser for the purpose of carrying the property abroad and actually carried in a continuous journey to a foreign destination, title and control of the automobile passing to the foreign purchaser upon delivery, are exempt sales in foreign commerce.

Copies of import documents of a foreign country or other documentary evidence of export must be obtained and retained by the dealer to support the exemption.

The auditor should also ascertain by whom the automobile was delivered to the dock or ship, and also that the unit was not delivered to the foreign purchaser in the state, returned to the dealer and then delivered to the dock by the dealer. The auditor should look for a dock receipt and a bill of lading in the deal folder. The dock receipt or other similar documentation is verification that the dealer delivered the vehicle from the dealer's place of business to the dock for shipment. The bill of lading or other documentary evidence is verification that the vehicle was shipped from the dock (port) to an out-of-state or foreign destination.

If delivery was made to the purchaser any time after the sale, or if the purchaser or his agent drove the automobile to the dock, sales tax applies to the sale.

A sale of a new, noncommercial motor vehicle manufactured in the U.S. and sold to a resident of a foreign country who arranges for the purchase through an authorized vehicle dealer in the foreign country prior to arriving in the U.S. is exempt from tax if:

1. the purchaser is issued an in-transit permit by DMV pursuant to section 6700.1 of the Vehicle Code, and
2. prior to or at the end of 30 consecutive days from the first day of operation under the in-transit permit, the motor vehicle is delivered or shipped to a point outside the U.S. by the retailer, by means of :
 - a. facilities operated by the retailer, or
 - b. a carrier, forwarding agent, export packer, customs broker or other person engaged in the business of preparing property or arranging for its export.

Pursuant to Regulation 1610(b)(2)(D), evidence of export of vehicles that are driven to a foreign country by employees of the retailer include employees' expense claims, fuel purchase receipts, and motel receipts. Auditors should examine a copy of the 30-day In-Transit Permit and a copy of the purchase order from the foreign authorized dealer. Evidence of support for export by other than the retailers' facilities include bills of lading and import documents of a foreign country.

COMMON CARRIERS

0611.35

The term “common carrier” means any person who engages in the business of transporting persons or property for hire or compensation and who offers these services indiscriminately to the public or to some portion of the public.

The sale of vehicles to common carriers is exempt from sales tax pursuant to Law Section 6385(a) when the vehicle is:

1. Shipped by the seller via the facilities of the purchasing carrier under a bill of lading, to an out-of-state point, and
2. Actually transported by the common carrier to the out-of-state destination, pursuant to the bill of lading, over a route the California portion of which the purchasing carrier is authorized to transport cargo under common carrier rights, and
3. Not put to use until after the transportation by the purchasing carrier to the out-of-state destination, and
4. Used by the carrier in the conduct of its business as a common carrier

A dealer claiming an exemption from sales tax under Law section 6385(a) must receive at the time of the transaction, and retain, a properly executed bill of lading (or copy) pursuant to which the goods are shipped. The bill of lading must show the seller as consignor. It must indicate that the described goods are consigned to the common carrier at a specified destination outside California. Where the form of the transaction is “freight collect,” no specific freight charge need be shown on the bill of lading, since such charges are not ordinarily shown on “freight collect” transactions. Furthermore, the carrier need not actually collect freight charges from itself. The form and language of the bill of lading should be similar to the form and language normally used where the purchaser and carrier are not the same. A bill of lading will be considered obtained at the time of the transaction if it is received either before the seller bills the purchaser for the property, within the seller’s normal billing and payment cycle, or upon delivery of the property to the purchaser.

Additionally, the seller must obtain from the purchaser prior to or at the time of the transaction, and retain, a certificate in writing that the property shall be transported and used in the manner described above and in Regulation 1621, Sales to Common Carriers. The certificate shall be in substantially the same form as Certificate A or B that appears in Regulation 1621.

In certain situations, the purchase of vehicles may be exempt from use tax under Regulations 1620 and 1621. See section 0611.15 for transactions involving interstate commerce. Similarly, use tax does not apply where vehicles purchased outside this state for use in other states or foreign countries are shipped to this state and remain here temporarily pending reshipment to such other states or foreign countries and are actually used solely outside this state (Law section 6009.1). If a vehicle purchased outside the state is assigned to interstate or intrastate use in this state, the question of whether it had been substantially used outside California before entry into this state or used in interstate commerce (so that use tax would not apply) arises and must be fully examined and commented upon by field auditors for submission to Headquarters.

MILITARY PERSONNEL

0611.40

Sales of vehicles in California to military personnel are subject to sales tax regardless of the service member's place of residence. The dealer must also collect use tax on the sale of vehicles outside this state to service members for use in this state, unless the sale is made prior to the effective date of discharge, and the intention to use the vehicle in California results from official orders transferring the service member to California and not from the service member's own independent determination. Service members will be considered to have made their own independent determination to use the vehicle in California, without regard to the time of receipt of official orders transferring them to California, if at the time they contract to purchase the vehicle they arrange to take receipt of the vehicle in California.

OVERSEAS DELIVERIES

0611.45

Sales to military personnel and overseas government employees claimed to be in interstate or foreign commerce often present problems of documentation. The purchasers travel on government orders and authorize shipping space for automobiles either to accompany them or to follow at a later date. The shipping involved is either a vessel operated by Military Sea Transport Service (MSTS) or a vessel under contract with MSTS. The purchaser or purchaser's agent will furnish the dealer with data for shipment and indicate the government facility to which the unit is to be delivered. All documentation prepared by the government indicates the purchaser as consignor and consignee. The documents consist of either a government bill of lading or automobile delivery receipt or both. Errors often arise in these documents by failure to show the party delivering to the government dock. More experienced dealers prepare their own delivery receipts and have the receiving authority sign for the vehicle. Auditors must be alert to vehicles accompanying the purchaser on the same vessel, since there is the tendency for dealers to give possession to the purchaser, and allow the purchaser to deliver the vehicle to the government facility.

FOREIGN MISSIONS AND CONSULS

0611.50

In general, sales and use tax applies to the sale and use of tangible personal property sold or leased to foreign governments. However, the sale or lease of vehicles to foreign missions or representative offices, foreign consular officers, employees, or members of their families will be exempt from the sales and use tax if at the time of the transaction, the purchaser or lessee provides a valid Tax Exemption Card (Personal, Mission, or Official) or protocol identification card to the retailer AND the U.S. Department of State, Office of Foreign Missions or the American Institute in Taiwan furnishes directly to the retailer or lessor a letter stating that the vehicle sale or lease to the purchaser is eligible for exemption from tax (eligibility letter). The retailer or lessor must retain a copy of the front and back of the Tax Exemption Card or protocol identification card and the eligibility letter to support the tax exemption.

For general information regarding tax exemption cards and sales and purchases of items other than vehicles, see AM section 0419.50.

LABOR AND REPAIR OPERATIONS**0612.00****GENERAL****0612.05**

The composition of Labor and Internal Sales deduction varies between dealers. Some dealers lump both type sales together as a single deduction, while others state them separately. In some cases, the deduction is used as a catchall for a combination of deductions. Due to the variations employed, it is necessary to inspect the sales tax working papers to determine the taxpayer's method and consistency in handling these types of transactions.

TESTS OF LABOR DEDUCTIONS**0612.10**

No inflexible rule can be established for testing repair orders. The volume of the service department, availability of repair orders, prior audit findings, and experience of the auditor all relate to the time needed to determine the extent of testing.

BILLINGS BASED ON ESTIMATES**0612.15**

Some dealers will prepare estimates on larger repair jobs, and invariably prepare detailed estimates for insurance companies. Usually, an itemized bid will show separately the price of labor, sublet labor, parts and tax reimbursement measured by the sales price of the parts. The bid may be given to either the customer (vehicle owner) or to the insurer.

Tangible personal property used in the actual repair work may differ from what was estimated when the bid was made. In such instances, some dealers enter the sales price of the property actually furnished in their books of account and report sales tax measured by that price.

An amount represented as the sales price of parts in an accepted bid is the taxable measure required to be reported by the repairer unless there is a subsequent modification of the bid agreement and the customer or the insurer is informed of the change; provided, however, that the sales price of the parts is not less than the cost of the parts actually used. The bid agreement may be modified by an invoice or a priced repair order given to the customer or the insurer showing the sales price of the property actually furnished by the repairer. If a bid is so modified and the customer or insurer is notified of the change, the amount represented as the sales price of the parts on the modified bid is the amount upon which tax must be reported.

When the accepted bid is in writing, the subsequent modification to the bid agreement must also be in writing. The customer or the insurer should be notified of such modification prior to completion of the sale (e.g., delivery of the repaired automobile).

SUBLET REPAIRS (OUTSIDE WORK)**0612.20**

The sublet repairs account is essentially made up of any repair work or servicing that cannot be performed at the dealer's facilities. The charge of the outside repairer is debited to Sublet Repairs (Inventory Account), and the billing to the customer on the repair order is credited to Sublet Repairs. The extent of sublets will vary from dealer to dealer with the size of the service facilities being the governing factor. The larger dealers will have facilities for the majority of servicing operations and consequently sublet only specialized work. The problem for the dealer is the segregation of parts and labor on the billings from the subrepairer, and the subsequent breakdown of the sale between parts and labor. A large portion of the sublet purchases are solely service or labor, e.g. body repair, painting, carwash.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SUBLET REPAIRS (OUTSIDE WORK)

(CONT.) 0612.20

Examination of the purchase journal and disbursements journal will disclose the subrepairers who perform the majority of outside work, and the subsequent examination of purchase invoices of those vendors will disclose the existence of parts billings and the manner in which the dealer recorded the parts. If necessary, the auditor should then examine the repair orders for the proper segregation of part sales.

FABRICATION LABOR AND SPECIAL PAINTING

0612.25

An unusual source of posting to a labor account is from the New Car or Truck Journal. These postings originate as the result of sales of new vehicles on which special work is performed. While dealers may consider the charges to be repair or installation labor, the charges are for fabrication labor on the sale of a finished product and thus taxable. The fabrication labor charge is posted to a labor account and may be improperly included in the labor deduction.

The charges most commonly made are for porcelainize, underseal, and special paint jobs. Examination of new car journals and scrutiny of posting references to the labor accounts normally will disclose the existence of these transactions. Less common are repair orders, prepared simultaneously with the new car invoice, on which charges for fabrication labor are made.

VEHICLE ENGINE EXCHANGES

0612.30

It is common practice among motor vehicle dealers to exchange reconditioned engines for worn engines. "Engine" as used here includes an entire engine, a short block, and a short, short block:

- a. An entire vehicle engine has a head and pan, but does not necessarily have a fuel pump, carburetor, distributors, etc.
- b. A short block is an engine cylinder block without cylinder head(s).
- c. A short, short block is an engine cylinder block without cylinder head(s) and without oil pan and oil pump.

The exchange of a reconditioned vehicle engine for a worn engine, together with the removal of the worn engine and installation of the reconditioned engine in a vehicle, constitutes an integral transaction, and tax applies to the total charge for making the exchange without deduction on account of charges for removal of the worn or installation of the reconditioned engine, or without addition on account of the value of the worn engine accepted in exchange. Also, if due to the defective condition of the worn engine, an additional amount is charged to the customer, tax applies to such additional charge.

If the dealer makes an accurate segregation of the charges for the labor of removing the old and installing the reconditioned engine, and bills such charges separately, the dealer may compute tax upon the amount separately charged for the reconditioned engine, provided such charge includes the fair retail value of the old engine removed from the customer's vehicle.

If the dealer replaces a worn engine with a new engine, the measure of tax is the full selling price of the new engine including the trade-in value of the old engine removed from the customer's vehicle and retained by the dealer.

If the dealer rebuilds (overhauls) the customer's own engine, the transaction is treated as a repair.

VEHICLE ENGINE EXCHANGES

(CONT.) 0612.30

Some dealers also exchange engines where no installation by the dealer is involved. The measure of tax when a new engine is sold “over-the-counter” must include the trade-in value of the old engine taken in exchange. If the dealer makes an “over-the-counter” exchange of a reconditioned engine, the transaction is governed by paragraph (b)(4) of Regulation 1546 and the measure of tax is the exchange price.

REPAIR PARTS

0612.35

When a repair part is sold at a reduced price because of a trade-in allowance or core deposit, the amount subject to tax will depend on whether a new, used, reconditioned or rebuilt part is sold. It will also depend on whether there is a discount given.

New and Used Parts

Sales of new or used parts are generally taxed on the total selling price less any discounts allowed. Tax applies to the price before any allowance for trade-ins (a reduction in price given to a customer for turning in an old part). For example, a new battery is sold for \$35, and a trade-in allowance of \$3 is given. Tax applies to \$35, not the buyer’s out-of-pocket cost of \$32. Similarly, a used engine is sold for \$450 and a \$25 trade-in allowance for the buyer’s old engine is given. Tax applies still to the \$450.

Its important to note that some retailers call trade-in allowances “core” charges or deposits. Regardless of the name, the allowance is included in the taxable selling price unless a rebuilt or reconditioned part is sold as explained below.

Reconditioned or Rebuilt Parts

When a reconditioned or rebuilt part is sold and a customer’s worn part is taken as an exchange, tax applies to the exchange price. The exchange price is the total amount received for the sale. For example, a rebuilt alternator is sold for \$125, and the customer is required to turn in his or her old alternator. The customer is charged \$125 if the used alternator is turned in at the time the rebuilt alternator is sold. Tax applies to \$125. However, if the customer does not turn in the old alternator at the time the rebuilt alternator is sold, a core deposit of \$15 is charged for a total \$140 selling price (the \$15 may or may not be separately stated). If the customer later returns an old alternator, the \$15 core deposit should be refunded to the customer. In this case, charges for the core deposit are not taxable, and the customer should be refunded the amount of sales tax collected on the charges for the core deposit. If the customer does not return an old alternator, the \$15 core deposit is retained. Tax applies to charges for the core deposit retained if the customer does not return the old alternator (tax on \$140).

Discounts

A discount given to the customer is not subject to sales or use tax. For example, if an engine (whether new or rebuilt) is sold for \$800 less a 10 percent discount of \$80 so that the total amount received for the sale is \$720 (\$800–\$80), tax is due on \$720. However, if the engine is sold for \$720 and a manufacturer’s coupon (or rebate) is accepted for \$80, then tax is due on the \$800 received for the sale: \$720 from the customer and \$80 from the manufacturer.

LUMP SUM REPAIRS

0612.40

The Business and Professions Code requires automobile repairers to prepare detailed estimates and invoices for their customers on all repair jobs except minor repairs of the type customarily performed by gasoline service stations. Sections 9884.8 and 9884.9 of this Code provides:

Section 9884.8

- All work done by an automotive repair dealer, including all warranty work, shall be recorded on an invoice and shall describe all service work done and parts supplied. Service work and parts shall be listed separately on the invoice, which shall also state separately the subtotal prices for service work and for parts, not including sales tax, and shall state separately the sales tax, if any, applicable to each. If any used, rebuilt, or reconditioned parts are supplied, the invoice shall clearly state that fact. If a part of a component system is composed of new and used, rebuilt or reconditioned parts, such invoice shall clearly state that fact.
- One copy shall be given to the customer and one copy shall be retained by the automotive repair dealer.

Section 9884.9

- The automotive repair dealer shall give to the customer a written estimated price for labor and parts necessary for a specific job. No work shall be done and no charges shall accrue before authorization to proceed is obtained from the customer. No charge shall be made for work done or parts supplied in excess of the estimated price without the oral or written consent of the customer which shall be obtained at some time after it is determined that the estimated price is insufficient and before the work not estimated is done or the parts not estimated are supplied.
- Nothing in this section shall be construed as requiring an automotive repair dealer to give a written estimated price if the dealer does not agree to perform the requested repair.
- The automotive repair dealer shall include with the written estimated price a statement of any automotive repair service which, if required to be done, will be done by someone other than the dealer or his employees. No service shall be done by other than the dealer or his employees without the consent of the customer, unless the customer cannot reasonably be notified. The dealer shall be responsible, in any case, for any such service in the same manner as if he or his employees had done the service.

The Department of Consumer Affairs, Bureau of Automotive Repair, licenses automotive repairers and administers these sections of the Code.

Most dealers comply fully with these provisions and have devised work orders which serve as both a written estimate and an itemized invoice.

Some dealers may advertise a set charge for certain major repair jobs, with the price inclusive of tax. The segregation of charges on such jobs is usually based on an experience factor. The amount of parts sales reflected by the posting segregation must be at the fair retail value. In those cases where tax reimbursement is shown on the invoice, the taxable measure will be in accordance with Regulation 1700, Reimbursement for Sales Tax, unless the measure so computed is less than the fair retail price of the parts.

CALIFORNIA TIRE RECYCLING FEES**0612.45**

The California Tire Recycling Act assesses a fee on the retail purchase of new tires intended for use with, but sold separately from, on-road or off-road motor vehicles, trailers, motorized equipment, construction equipment, or farm equipment. The fee also applies to new tires (including the spare) sold with the retail purchase of new or used motor vehicles, trailers, construction equipment, or farm equipment. The fee is imposed on the purchaser of the new tire and is collected and remitted by the retailer. The fee imposed is not part of the retailer's taxable gross receipts. If an amount in excess of the mandated fee is charged on the sale of a new tire, the excess amount is taxable.

When auditing a sales and use tax account that sells tires, the auditor should verify that the retailer holds a valid California Tire Fee account. If an account is not found to be in existence, the auditor should create a case in the Audit Springboard to prepare a Memorandum of Tax Liability. The form fields are similar to that of the CDTFA-1164, *Audit Memorandum of Possible Tax Liability*. Auditors should complete the case and import attachments. These should be routed to the Audit Examination Branch Administrator (MIC 48).

OIL RECYCLING, HAZARDOUS WASTE AND OTHER OVERHEAD FEES**0612.50**

The California Oil Recycling Enhancement Act provides that oil manufacturers must pay a fee for the first sale in California of lubricating oil and transmission or differential fluids. If the products are purchased from a California supplier, the supplier will pay the fee. If the products are imported from outside California, the dealer will be responsible for paying the fee directly to the state. The dealer can reimburse itself by charging the customer an amount equal to the fee. Charges for reimbursement of the Oil Recycling Fee are subject to tax even if separately stated on the invoice.

Car dealers are generally required to pay hazardous waste disposal fees, for the handling, management and disposal of waste products such as transmission fluid, antifreeze, motor oil, and oil filters when the waste is submitted to a disposal facility. The dealer can reimburse itself by charging the customer an amount equal to the fee. Separately stated charges for "hazardous waste fees" are not subject to tax if they are directly related to the nontaxable servicing (e.g., mileage service or oil changes) or repair of a customer's vehicle. Charges for hazardous waste fees are generally taxable when the fee is solely related to the taxable sale of tangible personal property and no repair or installation labor is involved.

If the dealer separately states a general overhead charge which does not relate solely to non-taxable labor or solely to the taxable sale, the charge must be prorated in the same ratio as the itemized taxable charges for parts bears to the itemized non-taxable charges for labor.

CREDIT TO EXPENSE ACCOUNTS**0612.55**

Credits to expense accounts for sales recorded in the sales journal are discussed in section 0607.45. In some instances, credits are found in the Parts, Accessories, and Service Journal. The amount charged on individual repair orders is small and the total amount per month is not substantial. These are estimated amounts for nuts, bolts, washers, etc., which because of negligible unit costs, are not controlled in the cost system.

Examination of the general ledger accounts and Service Journal will disclose the accounts involved, and examination of repair orders will determine if tax reimbursement was charged.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

**MODIFICATIONS TO VEHICLES USED BY
PHYSICALLY HANDICAPPED PERSONS**

0612.60

Tax does not apply to the sale, installation, storage, use or other consumption, in California of materials that: (1) are used to modify a vehicle so that a person with disabilities can operate it and (2) are incorporated into, attached to, or installed on the vehicle, regardless of whether the property is installed by the retailer or another person. Sales of tools and materials that are used to modify the vehicle, but which are not incorporated into, attached to, or installed on the vehicle, are subject to tax.

The following definitions apply to this exemption:

- Persons with disabilities include disabled persons who qualify for special parking privileges (as described in Vehicle Code section 5007).
- The term “vehicle” as used in this section refers to:
 - All devices that qualify as vehicles under the Vehicle Code sections 670, including, but not limited to automobiles, vans, trucks, mobile homes, and trailercoaches,
 - Vehicles that are (1) owned or operated by physically handicapped persons, or (2) used in the public or private transportation of handicapped persons and which would otherwise qualify for a distinguishing license plate if they were registered to a physically handicapped person(s) (as described in Vehicle Code section 5007).

FUEL SOLD OR CONSUMED IN NEW OR USED VEHICLES 0613.00

GENERAL 0613.05

Charges for fuel placed into the fuel supply tanks of motor vehicles by manufacturers, importers, or dealers may be subject to California sales or use tax in whole or in part. The principles involved in the proper application of tax to fuel consumed or sold with a motor vehicle should be applied consistently at the manufacturer, importer, or dealer level.

FUEL SOLD WITH VEHICLES 0613.10

The fuel in the fuel tank of the vehicle at the time of sale is considered to be sold as part of the vehicle whether or not the charge for the fuel is separately stated. If the vehicle is sold at retail, sales tax applies to the selling price inclusive of the fuel. If the vehicle is sold for resale, the fuel is also considered to be sold for resale.

FUEL CONSUMED IN VEHICLES 0613.15

Fuel placed in the fuel tanks of vehicles by manufacturers, importers, or dealers and not sold with the vehicle is considered to be consumed and subject to tax. For example, charges for fuel used by manufacturers or importers in testing, or preparing and loading vehicles for delivery, and fuel used by dealers for demonstration and personal or business use is subject to sales or use tax when consumed in California.

If fuel is purchased for resale, tax should be reported on the cost of the fuel not resold. If the fuel is purchased sales tax paid, a deduction for tax-paid purchases resold is in order measured by the cost of the fuel resold with vehicles. If fuel is purchased both for resale and sales tax paid, that which is purchased tax paid is considered to be consumed first, and that which is purchased for resale is considered to be sold first. If the fuel consumed exceeds the fuel purchased tax paid, tax should be reported on the cost of the excess. Conversely, if the fuel resold exceeds the fuel purchased for resale, a tax-paid purchases resold deduction is warranted on the cost of the excess.

FUEL USED IN DEMONSTRATORS 0613.20

Tax applies to all charges for fuel used in the operation of motor vehicles. Amounts reported by dealers for personal or business use of demonstrators under the 1/40th or 1/60th formula pursuant to Regulation 1669.5 do not include the cost of fuel consumed in the vehicles while being used for such purposes.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SELF-CONSUMED MERCHANDISE

0614.00

GENERAL

0614.05

In general, the verification of self-consumed merchandise of an automobile dealer will follow that of any other retailer; however, there are some special aspects involving demonstrators, company cars, service cars, maintenance of these cars, and other items. The circumstances and the special provisions applicable thereto are discussed in the following sections.

MANUFACTURERS AND DISTRIBUTORS OF MOTOR VEHICLES

0614.07

Motor vehicle manufacturing and distributing companies sometimes use their own vehicles for purposes which give rise to use tax liability.

For vehicles assigned for more than 12 months to persons for combined business and personal use and demonstration and display, or assigned to "pool service," manufacturers must pay the tax on the purchase price of tangible personal property used to manufacture the vehicle, and distributors must pay tax measured by their purchase price of the vehicle. When manufacturers and distributors either assign vehicles to persons for less than 12 months, or assign "pool" service vehicles to visiting dignitaries, etc., for less than 12 months, the measure of tax is the fair rental value based upon 1/40th of the net dealer purchase price for each month of combined demonstration or display and use.

VEHICLES CAPITALIZED AS ASSETS

0614.08

Except for vehicles held for the purpose of leasing, vehicles which are capitalized in an asset account and depreciated for income tax purposes are not held for sale in the regular course of business. Tax must be paid measured by the purchase price of such vehicles. (See Regulation 1669.5(a)(7).)

REGISTRATION

0614.09

If a vehicle manufacturer, distributor, dealer, or lessor registers a vehicle purchased for resale in a name other than that of the manufacturer, distributor, dealer, or lessor while retaining title to the vehicle, the vehicle is not held for sale in the regular course of business, and the manufacturer, distributor, dealer, or lessor must pay use tax measured by the purchase price of the vehicle. (See Regulation 1669.5(a)(8))

The only exception is the loan of vehicles to school districts, California State Colleges, the University of California and veteran's hospitals for driver education purposes as provided in Regulation 1669.5(a)(4). Issuance of exempt plates is limited to governmental bodies by regulations of the DMV, as the vehicles must be registered to them. Use tax will not apply in such cases.

RECORDING OF CARS USED AS DEMONSTRATORS**0614.10**

Dealers usually record cars placed in demonstrator service in an inventory account separate from the regular new car inventory. The account will be titled "Company Cars" or "Demonstrators." Depreciation is not claimed for income tax purposes on the cars recorded in these accounts. These accounts usually include the cost of demonstrators, as well as those cars assigned to salesmen, officers, partners, officials, and other employees. It may also include courtesy cars. Additionally, the number of demo cars can be scheduled from financial statement and traced to salespersons, managers, officers, and others who have the vehicles assigned to them. The auditor can also take inventory of dealer plates and determine who is operating the vehicle with these plates.

This transfer from the regular new car inventory account to the company car and/or demonstrator inventory account, is usually accomplished by an entry or series of entries in the general journal. In some instances, no entry will be made in the records, the cost of the cars being allowed to remain in the regular new car inventory account. Evidence of this being the case usually can be detected in one or more of the following ways:

1. Cryptic notations or signals in sales journals or on detailed new car inventory records.
2. Entries in demonstrator expense accounts, internal sales, etc.
3. Evidence of insurance coverage.
4. Notations on documents covering subsequent sales of demonstrators.
5. DMV Report of Sales. (Under the Motor Vehicle Code, dealers may operate demonstrators and company cars on dealer plates. The absence of a registration does not, therefore, preclude a taxable use of a car by the dealer.)
6. Separate stock cards file. Stock cards are sometimes used to account for cars in demonstrator status.
7. Repair orders may have a notation that the vehicle being repaired is a demonstrator.
8. Inquiry of the taxpayer.

RENTAL TO SALESPERSONS FOR DEMONSTRATION**0614.12**

Dealers who rent vehicles which are not mobile transportation equipment to their salespersons are regarded as making continuing sales of the vehicles and must collect and pay tax on the rental receipts, unless tax was timely paid measured by the purchase price of the vehicles. However, if the rental receipts are less than 1/60th of the dealer's purchase price of the vehicle for each month of the rental, the transaction will not be considered a bona fide rental, and tax will be measured by 1/60th of the purchase price for each month of such use. Tax applies to sales by dealers to their salespersons of vehicles to be used for demonstration and personal use. (See Regulation 1669.5(a)(10))

DEMONSTRATION AND DISPLAY**0614.15**

Regulation 1669.5, Demonstration, Display and Use of Property Held for Resale — Vehicle, provides that a purchaser of a vehicle under a resale certificate, who uses the property solely for demonstration or display while holding it for sale in the regular course of business, is not required to pay tax on account of such use. Demonstrators owned by dealers who do not allow their personnel to use such vehicles for purposes other than demonstration and display fall within the exemption.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

TYPES OF VEHICLES NOT ORDINARILY SOLD

0614.17

If a vehicle dealer or lessor purchases under a resale certificate a new vehicle of a type which the dealer is not franchised to sell, or does not ordinarily sell or lease as a new vehicle, and uses the vehicle for any purpose other than, or in addition to, demonstration or display, it will be presumed that the dealer is not holding the vehicle for sale in the regular course of business and that tax is due, measured by the purchase price of such vehicle. (See Regulation 1669.5(b)(1))

Note: Vehicle Code section 11713.1(f)(1) prohibits a dealer from purchasing a new motor vehicle for resale of a line-make for which the dealer does not hold a franchise. This is sufficient basis for not regarding the selling dealer as having accepted the resale certificate in good faith. (See section 0609.20)

APPLICATION OF TAX TO DEMONSTRATORS

0614.20

Dealers or lessors who allow their employees to use vehicles for purposes other than demonstration and display are liable for the tax on the fair rental value of the vehicles for the period of such other use.

Dealers who issue resale certificates and then use automobiles for purposes other than demonstration or display while holding them for sale in the regular course of business are liable for use tax measured by the sales price of the automobile to them. However, when a series of vehicles are used in this manner for periods of less than six months, the use tax will be measured by the average cost of one vehicle for each 12 month period for each person to whom such cars are assigned. The average cost will be the weighted average of the cost of all vehicles so used by that particular person during the 12 month period. Tax applies to the subsequent retail sale of such vehicles. This includes vehicles used in the corporate officers' or employees' personal households that are assigned to the spouse of a corporate officer or employee when the vehicles are regularly available for use, including demonstration and display, by the corporate officer or employee.

Regulation 1669.5 establishes the presumptions listed below with respect to vehicles that are registered in the name of the dealer or lessor and vehicles that are not registered. The presumptions established by the regulation determine whether vehicles are frequently demonstrated and the measure of the fair rental value. These presumptions may be rebutted only by clear and convincing evidence to the contrary.

- When a vehicle dealer or lessor assigns a demonstrator to vehicle sales personnel for a period not exceeding 12 months, the measure of tax is the fair retail value at 1/60th of the purchase price for each month of combined demonstration or display and use.
- When a vehicle dealer or lessor assigns a vehicle to employees or officers other than vehicle sales personnel for a period not exceeding 12 months, the measure of tax is the fair rental value at 1/40th of the purchase price for each month of combined demonstration or display and use.
- When a vehicle dealer or lessor assigns a vehicle to a person other than an employee or officer, such as a relative or business associate, the measure of tax is the purchase price of the vehicle.
- When a dealer or lessor assigns a vehicle to a person for more than 12 months for business or personal use in addition to demonstration and display, the measure of tax is the purchase price of the vehicle. The 1/40th or 1/60th formula, as appropriate, may be used if the duration of combined use is not known at the outset, with the difference between cost and the formula to be paid when use exceeds 12 months.
- When a vehicle is purchased for resale and registered in the name of the dealer, the measure of tax is the fair rental value computed at 1/40th of the purchase price for each month of combined demonstration or display and use.

APPLICATION OF TAX TO DEMONSTRATORS

(CONT.) 0614.20

The following table illustrates the tax application to demonstrator vehicles which are also used partly for purposes other than demonstration and display.

VEHICLE OPERATOR	PERIOD VEHICLE IN DEMO SERVICE	MEASURE PER MONTH
Sales personnel	12 months or less	1/60th of cost
Sales personnel	More than 12 months	Cost less reported demo credit
Nonsales personnel	12 months or less	1/40th of cost
Nonsales personnel	More than 12 months	Cost less reported demo credit
Nonemployees	No requirement necessary	Cost

Used Car Dealers

A number of situations, which are often encountered when auditing used car dealers, require consistent handling.

1. Where a used car dealer is found to be taking different cars for business and personal purposes rather than using one car for a period exceeding 12 months, it is reasonable to assume they are frequently demonstrated and displayed and the use of the 1/60th formula is appropriate.
2. Where the used car dealer is using one car for a period exceeding 12 months, additional proof of frequent demonstration and display is required if the 1/60th formula is to be used in lieu of the “cost of one car per year” method.
3. Generally, a new car purchased by a used car dealer or a new car dealer not franchised to deal in the type of car purchased, is not frequently demonstrated and displayed, but rather purchased for personal use. Accordingly, unless there is convincing evidence to the contrary, such automobiles should be tax-paid on cost. An example is a Volkswagen dealer purchasing a Cadillac under a resale certificate.

COURTESY VEHICLE LOANS

0614.25

GENERAL

Motor vehicle dealers loan vehicles (loaner vehicles) to their customers under various situations. The application of sales or use tax depends upon how the dealer obtains the vehicle and under what circumstances the vehicle is loaned to the dealer’s customer. For information on how the California Tire Recycling Fees apply to courtesy vehicle loans, see AM section 0612.45, Tire Recycling Fee.

When a dealer buys a vehicle exclusively for use as a loaner vehicle for customers, while the dealer is servicing or repairing customer-owned vehicles, it is considered a company vehicle and the dealer cannot issue a resale certificate when purchasing the loaner vehicle. Sales tax applies to the sale of the vehicle to the dealer, or if they purchase the vehicle without paying tax, the dealer owes use tax based on the purchase price of the vehicle. If the dealer later resells the vehicle, the dealer is responsible for the tax, based on the selling price of the vehicle, since the sale is a separate sales transaction.

However, there may be instances in which a dealer does not maintain an inventory of vehicles for use exclusively as loaner vehicles, but obtains a vehicle for use as a loaner vehicle for some amount of time. Typically, the dealer would obtain the vehicle from one of the following:

- Resale or lease inventory,
- Purchased or leased under a special accommodation program, or
- Leased from a third-party lessor (i.e., car rental agency)

Vehicles Purchased Under a Resale Certificate

When a dealer purchases a vehicle under a resale certificate, and otherwise holds a vehicle for resale, loans the vehicle to a customer who is awaiting delivery of a vehicle purchased or leased from the dealer, or awaiting the repair of their vehicle by the dealer, the dealer owes tax on that use (the loan), except as explained below. When tax applies, the measure of tax is the fair rental value of the loaned vehicle for the duration of each loan so made.

When a vehicle is loaned to a person who is not a customer, but is awaiting delivery of a vehicle purchased or leased from the dealer, or the return of a repaired vehicle by the dealer, tax would generally be measured by the purchase price. However, if such loan is for a very short period of time, combined with frequent demonstration or display while holding the vehicle for sale in the regular course of business, the tax liability may instead be based on fair rental value of the loan.

When the loan of a vehicle is not combined with frequent demonstration or display during the loan period but is loaned for a period of 30 days or less to a person, other than a customer awaiting delivery of a vehicle or return of a repaired vehicle, tax is due on the fair rental value, provided the loaned vehicle was frequently demonstrated or displayed prior to being loaned and continues to be demonstrated or displayed following its loan. However, if the loan period does not constitute an incidental use (30 days or less), tax is measured by the purchase price of the loaned vehicle.

When a lessor loans a vehicle to a lessee who is awaiting delivery or return of a leased vehicle, and the regular lease payments continue to accrue during the period of the loan, the regular lease payments will be considered to cover the use of the loaned vehicle. If the lease is a continuing sale, and use tax is being collected and remitted on the regular lease payments, no additional tax is due as a result of the loan.

Special Courtesy Vehicle Loan Programs

Many vehicle manufacturers offer incentives to dealers to participate in Special Accommodation Programs (SAPs). SAPs require dealers to maintain an inventory of a certain number of vehicles for the specific purpose of loaning the vehicles to customers who are waiting for their leased and/or owned vehicles to be repaired or serviced. Generally, dealers purchase these courtesy loan vehicles under a resale certificate. Distributors sell the vehicles to dealers with the understanding that the dealers will use the vehicles exclusively for accommodation loan purposes for a certain period of time. After that period, the dealers may sell the vehicles and collect tax reimbursement from their customer.

In many cases, the transaction between the distributor and dealer involves a finance company (generally related to the distributor). The dealer purchases vehicles from the distributor, immediately resells the vehicles to the finance company, and leases them back. In most cases, the lease from the finance company to the dealer is considered a sale at inception. In exchange for agreeing to the restrictions on use of the vehicle and ability to sell the vehicle, the dealer's lease payments may be subsidized.

Taxable Measure Under These Programs

If a dealer provides a courtesy accommodation loan to a customer who is awaiting the repair of a vehicle leased from that dealer or another dealer who is part of the manufacturer's courtesy accommodation program, and the lease is a continuing sale, the vehicle loan is part of that continuing sale. In these situations, the loan is regarded as part of the lease constituting a continuing sale and no further tax is due with respect to the vehicle loan made to the person leasing that vehicle.

Accordingly, dealers participating in the manufacturers' courtesy loan program may issue resale certificates to distributors for purchases of vehicles used exclusively as accommodation loans to persons leasing vehicles in continuing sales. However, except as discussed below, when dealers loan these vehicles to customers who own their vehicles (and to those whose leases are not continuing sales), the dealers are regarded as using the vehicles and owe use tax measured by the fair rental value of the vehicles loaned for the duration of each loan so made.

Dealers should retain appropriate documentation to substantiate any claimed exclusion from tax measured by the fair rental value. Dealers should maintain documentation such as repair invoices, lease agreements, service or maintenance retention schedules, and other pertinent documents that support amounts claimed by the dealer. Sufficient documentation to distinguish between vehicle loans made to customers who own their vehicles and those leasing under a continuing sale must be retained by the dealers. If the dealer does not maintain the required documentation, the dealer owes tax on the fair rental value for all courtesy accommodation loans of these vehicles. Where California Department of Tax and Fee Administration (CDTFA) establishes a deficiency, the burden is upon the taxpayer to explain the discrepancy between its books and records and the results of CDTFA's audit.

In some instances, vehicle dealers do not actually lease vehicles. A separate related finance company or arm of the dealership or distributor becomes the ultimate lessor. Also, the lease agreements may show the dealership as the original lessor, but the lease is later assigned to a separate business where all lease payments are remitted. Under these circumstances, where an accommodation loan is made to a customer awaiting repair of a vehicle leased in a continuing sale from the dealer, another dealer who is part of the integrated manufacturer's courtesy accommodation program, or a finance company related to such a dealer, no further tax will be due on an accommodation loan.

If a dealer does not offer similar vehicles as a daily rental to customers not awaiting delivery of vehicles purchased or leased from the dealer or being repaired by the dealer, then the fair rental value is the amount for which other dealers in the area rent similar vehicles for similar periods to persons who are not customers awaiting delivery of vehicles purchased or leased or repaired by the dealer. (Regulation 1669.5(b)(6)) If a similar vehicle is not leased (e.g., Lexus and Infiniti dealerships do not generally rent their vehicles), then a reasonable monthly fair rental value of the accommodation loan vehicle will be obtained by using 1/40th of the purchase price of the vehicle method as outlined in Regulation 1669.5(b)(3)(A). The monthly fair rental value based on 1/40th of the purchase price of the vehicle may be prorated to determine a daily fair rental value when the dealer's use of the vehicle as a loaner is for only a fraction of the month. Standby time in which the loaner vehicle is waiting to be loaned to customers is not considered a taxable use.

Mandatory or Standard Manufacturer's Warranty

As part of a mandatory or standard manufacturer's warranty, the manufacturer or warrantor may include a courtesy transportation program that provides the vehicle owner or lessee with a loaner vehicle while their vehicle is in for repair. When the loan of the vehicle is in fulfillment of the contract requirements of a mandatory or standard manufacturer's warranty upon which tax or tax reimbursement was paid at the time of sale, the loan of the vehicle is regarded as part of the original sales contract or lease agreement for the vehicle being repaired. The vehicle loans are not considered accommodation loans; they are considered part of the original sale contract.

When the vehicle being repaired is owned by the customer, tax does not apply to the use of the loaned vehicle. The loan of the vehicle is regarded as part of the original taxable sale or contract price of the vehicle being repaired for which the measure of tax included the warranty. Dealers may lease the vehicles from third parties ex-tax for resale or provide one of their own resale vehicles in fulfillment of the provisions of the original taxable sale.

Optional Warranty

When the warranty is optional, the dealer, obligated under the contract, is considered the consumer of the loaned vehicle. As the consumer, the dealer makes a taxable use of the loaned vehicle. Whether the loan of the vehicle is in fulfillment of the provisions of an optional warranty or an accommodation loan, tax is generally due on rentals payable (if the loaned vehicle is rented from another source) or fair rental value (if taken from resale inventory).

With respect to vehicles loaned to lessees of vehicles, it is irrelevant whether the lease contract requires the dealer and/or lessor to provide the lessee a loaner vehicle while the lease vehicle is being repaired. If the lease is a taxable continuing sale, the use of the loaned vehicle is regarded as part of the taxable continuing sale. Dealers/lessors may lease the vehicles from third parties ex-tax for resale or provide one of their own resale vehicles as part of the taxable continuing sale.

If the lease is not a taxable continuing sale (tax or tax reimbursement was paid on the purchase price of the vehicle), the dealer/lessor is not regarded as making a loan of the vehicle as part of the taxable continuing sale. Thus, the dealer/lessor is regarded as using any loaner vehicle provided to the customer whether that loan is required by the lease contract or not. The dealer/lessor may not lease the vehicle from a third-party ex-tax for resale. If the dealer/lessor makes a use of one of its own resale vehicles, tax is generally due on fair rental value.

Loaner Vehicles From Third-Party Lessors

Dealers may lease vehicles from third-party lessors to use as loaner vehicles for their customers. Third-party leases include those from car rental agencies or vehicles leased under a SAP (as explained above) to use as loaner vehicles. Generally, a dealer may issue a timely resale certificate to the third-party lessor when the leased vehicle will be used as a loaner vehicle (1) for their customer whose vehicle is being serviced or repaired under a mandatory or standard manufacturer's warranty, or (2) for their customer whose leased vehicle is being serviced or repaired, or (3) for a customer who is awaiting delivery of their newly leased vehicle and the customer's regular lease payments continue to accrue. However, in some instances, the dealer may lease a vehicle and pay tax to the lessor measured by the lease receipts. The following explains how tax applies to three different types of courtesy loans when dealers obtain loaner vehicles from third-party lessors and pay tax on their lease receipts.

COURTESY VEHICLE LOANS

(CONT. 4) 0614.25

1. Customer is provided a loaner vehicle as a courtesy.

When a dealer loans a vehicle to their customer free of charge solely as a courtesy (for example, the customer-owned vehicle is being repaired or serviced under an optional warranty or their customer is awaiting delivery of their new vehicle), the dealer makes a use of the vehicle, and the tax applies to the lease of the vehicle to the dealer. In this instance, the dealer may not claim a tax-paid purchases resold credit or file a claim for refund for the tax paid to the third-party lessor on the lease payments.

2. Customer's vehicle is being serviced or repaired under a mandatory or standard manufacturer's warranty.

When a dealer loans a vehicle to their customer whose vehicle is being serviced or repaired under a mandatory or standard manufacturer's warranty, the loan of the vehicle is considered part of the original sales contract and no additional tax is due. In this situation, the dealer may claim a tax-paid purchases resold credit on their sales and use tax return or file a claim for refund for the tax paid to the third-party lessor on those lease payments that are for the period(s) of nontaxable use.

3. Customer's leased vehicle is being serviced or repaired or customer is awaiting delivery of their newly leased vehicle.

When a dealer loans a vehicle to their customer whose leased vehicle is being serviced or repaired, or to a customer who is awaiting delivery of their newly leased vehicle and the customer's regular taxable lease payments continue to accrue, no further tax is due. The dealer may claim a tax-paid purchases resold credit on their sales and use tax return or file a claim for refund for the tax paid to the third-party lessor on those lease payments that are for the period(s) of nontaxable use.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

COMPANY CARS

0614.30

Company cars are those vehicles available chiefly for company use by employees and with very little use, if any, for demonstration and display. These cars will usually be recorded in the same account as demonstrators. *The dealer must include the cost of such vehicles in the measure of tax paid . In the case of vehicles owned by factory branches, use tax would, apply to the material used in manufacturing the car.*

SERVICE CARS

0614.35

The cost price of service cars, parts and service department vehicles, and tow trucks would be subject to tax.

New Vehicles:

The accounting systems prescribed by the major manufacturers require the cost of these vehicles to be capitalized in a fixed asset account and depreciated for income tax purposes. The account will usually be known as "Service Cars" or "Equipment."

Used Vehicles:

All automobiles acquired by dealers from nonretailers as well as other dealers are subject to the use tax if placed in company service. The dealer would normally register the vehicle to the dealership by use of a used car Report of Sale. No use tax would be paid to DMV on a transaction handled in this manner, hence the auditor should be alert for undeclared use tax as a result of such transactions.

LOANS TO SCHOOLS, COLLEGES, AND VETERANS' INSTITUTIONS FOR EDUCATIONAL OR TRAINING PROGRAM

0614.40

Section 6404 of the Sales and Use Tax Law exempts a retailer from collecting the use tax on tangible personal property loaned to any school district for an educational program conducted by the district.

When a vehicle or tangible personal property is leased or sold to the school district, tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold. School districts include only tax supported districts of a city or county; they do not include private schools.

Section 6404 of the Sales and Use Tax Law extends the use tax exemption to the loan by any retailer of any motor vehicle to:

- a. California State Colleges or the University of California for the exclusive use in an approved driver education teacher preparation certification program.
- b. An accredited private or parochial secondary school for the exclusive use in a driver education and training program approved by the State Department of Education as a regularly conducted course.
- c. A Veterans Hospital or such other nonprofit facility or institution to provide instruction in the operation of specially equipped motor vehicles to disabled veterans.

When a vehicle is leased or sold to (a) or (b), tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold. When a vehicle is leased or sold to (c), tax applies on rental receipts or cost of the units leased or on the selling price if the unit is sold to any nonprofit facility or institution other than the Veterans Administration.

Refer to Section 0614.09 for registration qualifications when the organization to which the vehicle is loaned is a governmental body.

LOANS OF AUTOMOBILES TO UNIVERSITY EMPLOYEES

0614.42

Operative January 1, 1997, Section 6202.7 was added to the Revenue and Taxation Code. This law specifies that a retailer who loans any motor vehicle to any University of California or California State University employee must collect use tax on that loan measured by the fair rental value for the period of the loan, provided all of the following conditions are met:

- a. The vehicle is for the employee's exclusive use.
- b. The loan has been approved by the chancellor of the university or president of the state university.
- c. It is demonstrated that the loan is not dependent upon the retailer receiving any future business from the university.

Prior to January 1, 1997, a loan of a vehicle to U.C. or California State University for use in other than educational purposes, for a period exceeding 30 days and not frequently demonstrated and displayed, would have resulted in use tax due on the dealer's cost of the vehicle. Effective January 1, 1997, the vehicle loan is not limited to the use for educational purposes. It could be used by a university employee for any reason, e.g., going to the store, vacations, etc. and duration of the loan could exceed 30 days. The dealer would be liable for the fair rental value of the vehicle over the duration of the loan.

RENTALS TO OTHER THAN EMPLOYEES

0614.45

Dealers may rent vehicles to persons other than employees under the provisions of Regulation 1660, Leases of Tangible Personal Property — In General. Besides rentals to persons in no way connected with the dealership, dealers sometimes rent to members of the families of management personnel who do not qualify under Regulation 1669.5. The amount of rental must be commensurate with the value of the car; and if it is not, the cost of the car must be included in the additional measure of tax.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

COMPANY AND SERVICE CAR REPAIRS AND MAINTENANCE

0614.50

Expenses for repairs and maintenance of company cars and service cars are recorded as Demonstration Expense or Company Car Expense. The cost is recorded in the internal journal based on repair orders or counter sales invoices. In examining the detail of the posting to expense, auditor can ascertain the internal sales account credited, which will be the basis for establishing self-consumption. The tax treatment of the expense items is as follows:

TYPE OF VEHICLE	GASOLINE OIL, GREASE	PARTS ACCESSORIES
Cars taxable on 1/40th or 1/60th formula basis	Taxable	Non-taxable
Vehicles used as demonstrators only	Taxable	Non-taxable
Loan cars taxable on fair rental value	Taxable	Non-taxable
Loan cars tax paid on cost	Taxable	Taxable
Company cars, service cars, tow trucks	Taxable	Taxable
Vehicles held for sale only and neither demonstrated nor used	Non-taxable	Non-taxable

PAINT DEPARTMENT

0614.55

Where the dealer is engaged both in the sale of paint and its use in the service department for repainting customers' cars, the dealer is considered the consumer of paint purchased for resale and used in repainting customers' cars (Regulation 1551, Repainting and Refinishing). The cost of paint so used should be reported as self-consumed merchandise.

Paint sold to customers will be recorded on counter sales invoices and reflected as sales of the Parts Department. Charges for repainting customers' cars are made on repair orders and recorded in the parts, accessories, and service journal. Special paint jobs in conjunction with new car sales are recorded in the new car journal and are taxable as part of the new car selling price.

The auditor should establish the source of paint sales from examination of ledger accounts, and in turn the method of recording from the respective journals. The status of purchases being tax paid or ex-tax is readily established from purchase invoices.

On repair orders for repainting a customer's car, some dealers make a separate charge for paint material. If this is done, the dealer is selling paint at retail and is not the consumer as mentioned above.

Labor charges for painting a used part, or a new part before or after installing it on a used vehicle, are not taxable.

GREASE AND OIL

0614.60

Dealers are consumers of grease and oil used in the performance of lubrication service. The majority of dealers purchase these materials ex-tax, since some portion will be used in used car reconditioning and new car preparation. In these cases, the lubricant is sold with the car and no tax liability for self-consumed materials exists. Liability for materials used on redemption of lube coupons is based on dealers handling of lube book sales. (See section 0607.85)

MISCELLANEOUS PURCHASES

0614.65

A test will usually be made of purchase invoices, with the extent of test based on size of dealership, prior audit findings, and the experience of the auditor. Purchases of fixed assets and expense items subject to use tax are the type of purchases most readily found.

Advertising specialties often are a major item. While license frame holders and key cases are normally in this category and purchased ex-tax, the majority of dealers provide these items with the new or used car and thus sell the frames or key cases with the car.

The nuts, bolts and cotter pins are often charged to an expense account when purchased. However, these items are considered as sold along with the part with which they are used. Therefore, if parts are sold, no measure of self-consumed merchandise would exist for the cost of these supplies. Some nuts and bolts are used on repair jobs on which no parts are sold and the cost of the supplies so used would be taxable.

The test should not be conducted in the initial stages of audit, but held in abeyance until the pattern of the dealer's operation is clear. The test is more meaningful if the examination is made to determine purchase details of sublet repair charges, paint, grease, tools, and supplies in addition to use tax purchases.

AUTO BODY REPAIR AND PAINT SHOP SUPPLIES

0614.70

Dealers and other businesses performing auto body work are generally considered the retailers of parts and materials remaining on the vehicle or item being repaired. The following are examples of parts and materials remaining on the vehicle or item being repaired that may be purchased for resale by auto body repair and paint shops:

Automobile Parts	Glues/Adhesives	Primers
Clear Coats	Hardeners	Putties
Electrical Tape	Paints	Rust Protectors
Fillers	Polishes/Wax	Sealers
Fisheye Eliminator		

These types of parts and materials may be purchased for resale and tax charged on the selling price, if they are itemized on the sales invoice. The purchaser must issue a resale certificate to the seller in order to purchase items for resale. The minimum requirements of a valid resale certificate are set forth in subdivision (b)(1) of Regulation 1668.

However, in certain situations relating to painting and body work, businesses are considered the consumer, not the retailer, of parts and materials. If the value of parts and materials provided in connection with repair work on a used vehicle is 10 percent or less of the total charge and billed lump-sum, the repairer (or dealer) is the consumer of parts and materials, and owes tax on his/her cost.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

AUTO BODY REPAIR AND PAINT SHOP SUPPLIES

(CONT.) 0614.70

Dealers and other auto body and painting businesses are considered consumers of tools and supply items that do not remain on the item being repaired. The following items are consumed by auto body repair and paint shops and generally are not purchased for resale:

Abrasives	Hand Cleaners	Polishing Compounds
Books	Manuals	Polishing Machine
Cans	Masking Paper	Reducers
Cleaning Solvent	Masking Tapes	Respirators
Color Charts	Masks	Rubbing Compounds
Equipment	Metal Conditioners	Rubbing Machine
Equipment Repair Parts	Paint Remover	Thinners
Goggles	Plastic Bottles	Touch-Up Bottles

Auto body repair and paint shops should pay tax reimbursement at the time of purchasing these supply items. If the purchaser does in fact resell any of the above items prior to use, the purchaser can recover the tax reimbursement paid to the seller by taking a tax paid purchase resold deduction on line 10(b) of the purchaser's sales and use tax return. (See section 0419.25 for discussion of tax paid purchases resold.) If any of the above items are purchased exclusively for resale, the item(s) may be specifically listed on the resale certificate. Form CDTFA-230-A, Auto Body and Paint Industry Resale Certificate (published on the CDTFA's website), is a specific resale certificate that may be used by auto body repair and paint shops (Reg. 1668). Please note, auto body and repair shops are encouraged, but not required to use Form CDTFA-230-A. General resale certificates that meet the requirements of Regulation 1668 are acceptable.

Many automobile body repair shops make a separate charge to their customers for the cost of "supplies" as an extension of their charges for repair labor. Such separate charges for "supplies," as an extension of the repair labor charge, which do not become a component part of the refinished article are not subject to tax on the selling price since title or possession of supplies is not transferred to the customer. The repair shop or dealer is the consumer and owes tax on their cost. However, if the evidence discloses that the charge for "supplies" is a surcharge on the sale of repair parts, the charge for "supplies" is subject to tax.

BAD DEBTS AND REPOSSESSION LOSSES

0615.00

Deductions for accounts found to be worthless and for losses resulting from repossessions are proper if there has been compliance with the requirements of Regulation 1641, *Credit Sales and Repossessions*, and Regulation 1642, *Bad Debts*.

Bad debts charged off for income tax purposes, or if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles, usually will be greater than amounts allowable as a deduction for sales tax purposes. They will include labor, sales tax, resales, interstate sales, etc.

If the taxpayer has not claimed repossession losses, or has claimed the entire book loss, the taxpayer should be asked to schedule each loss in accordance with Regulation 1642. Where the repossessions are voluminous, or the back-up data is not readily available, the deduction may be computed on a test basis, and the results of the test applied to recorded amounts. The dealer should be required to compile the test data. The deduction should not be computed by applying a percentage which is estimated, unsupported, or based on audits of other dealers.

The auditor should verify that recoveries of bad debts previously claimed or allowed by the auditor are included in the reported taxable measure.

Amounts the taxpayer received from collection agencies may not include the total recoveries since collection agencies may withhold their fee. The amount retained by the collection agency should be added to the recorded recoveries, as it is an expense of collection and not exempt from tax.

THE LEMON LAW

0616.00

GENERAL

0616.05

The California Lemon Law (California Civil Code section 1793.2 through 1793.26) establishes consumer protection provisions for qualifying new motor vehicles and other motor vehicles sold with a manufacturer's new car warranty (e.g., dealer-owned vehicles), purported to have major manufacturing defects. Should a manufacturer be unable to service or repair a new motor vehicle to conform to the applicable warranties after a reasonable number of attempts, the manufacturer is required by law either to replace the motor vehicle or reimburse the customer (make restitution) at the customer's election. Arbitration is not required before the CDTFA is authorized to make a refund as long as the specified requirements in the Civil Code are satisfied.

DEFINITIONS

0616.10

For purposes of the Lemon Law, the term "manufacturer" means a new motor vehicle manufacturer, manufacturer branch, distributor, or distributor branch. "New motor vehicle" means a new motor vehicle that is bought or used primarily for personal, family or household purposes. "New motor vehicle" also means a new motor vehicle with a gross vehicle weight under 10,000 pounds that is bought or used primarily for business purposes by a person, including a partnership, limited liability company, corporation, association, or any other legal entity, to which not more than five motor vehicles are registered in this state. "New motor vehicle" includes the chassis, chassis cab, and that portion of a motor home devoted to its propulsion, but does not include any portion designed, used, or maintained primarily for human habitation. The following is a list of vehicles that do not qualify under the Lemon Law:

1. Motorcycle.
2. Motor vehicle not registered under the Vehicle Code because it is operated or used exclusively off the highways.
3. Vehicle purchased out-of-state.
4. Used vehicles not sold with a manufacturer's new car warranty.

RESTITUTION OR REPLACEMENT**0616.15**

If the manufacturer, through its dealership, is unable to restore the vehicle to mandatory warranty conformity, the dealership can be authorized by the manufacturer to handle the transaction as a “Lemon Law” transaction. It is the field auditor’s responsibility to verify that transactions in which the dealer participated qualify under the Lemon Law. If the auditor discovers evidence that the transaction was not handled by the manufacturer in accordance with the Lemon Law, an informational memo (CDTFA–1164) should be prepared for inclusion in the manufacturer’s file and a copy should be forwarded to the Headquarters’ Audit Determination and Refund Section.

Under the Lemon Law, the customer has the option to select either monetary restitution or vehicle replacement.

When the Customer Selects Monetary Restitution

The manufacturer must pay an amount equal to the actual price paid or payable by the customer, including any sales tax reimbursement, license fees, registration fees, and other fees, plus any incidental damages to which the customer is entitled. The manufacturer may deduct for usage of the defective vehicle and any amount charged for non-manufacturer items installed by the dealer. These amounts must be deducted from the original vehicle selling price before calculating the sale tax refund. See Example 1 for the calculation of sales tax refund.

When The Customer Selects Vehicle Replacement

Most Lemon Law transactions involving vehicle replacement are coordinated by manufacturers through their dealerships. The vehicle replacement is considered a part of the original sale under a mandatory warranty. When manufacturers adhere to this provision, they should only file a claim for refund when the value of the replacement vehicle is less than the original vehicle and the customer has been refunded the difference, including applicable sales tax reimbursement.

Acceptable Procedures for Vehicle Replacements:

1. The customer selects a replacement vehicle with a value greater than the credit given for the original vehicle. The dealership is liable for the sales tax on the amount the customer pays in excess of the credit given for the original vehicle (the incremental amount). License (registration) and amounts billed for non-taxable fees included in the credit given for the original vehicle should not be deducted from the price of the new vehicle when calculating the amount subject to tax. The dealership must report only the incremental amount (the difference between the replacement vehicle and the credit allowed for the original vehicle) on its sales and use tax return as a taxable sale, rather than the full amount of the sales price of the replacement vehicle. See Example 2 for the calculation of sales tax due.
2. The customer selects a replacement vehicle with a value less than the credit given for the original vehicle. The manufacturer should refund the difference to the customer, including sales tax reimbursement. The manufacturer may seek a refund of sales tax included in the amount reimbursed to the buyer by filing a claim for refund with the CDTFA. The dealership should not report this replacement transaction on its sales and use tax return. See Example 3 for the calculation of sales tax refund.
3. The customer selects a replacement vehicle with an equivalent price and an exchange of vehicles occurs at no additional cost. Since the credit for the returned vehicle is the same as the negotiated sales price of the replacement vehicle and no additional amount is required to be paid, the transaction should not be reported on the dealer’s sales and use tax return. The manufacturer should not file a claim for refund for the sales tax on the original vehicle.

Alternative Method

Effective January 1, 2004, this method of calculating the sales tax for replacement vehicles is no longer acceptable.

A number of vehicle dealers currently treat replacement transactions as separate and distinct from the original transaction. Thus, the full selling price of the replacement vehicle is treated as taxable. Under these circumstances, manufacturers typically provide a credit to the buyer toward the purchase of the replacement vehicle from a dealership. The credit is most often noted directly on the sales contract of the replacement vehicle. Manufacturers are not allowed to file claims for refund of sales tax included in the credit allowed for the original vehicle on the replacement transaction, if the credit allowance results in the manufacturer receiving a sales tax refund in excess of the amount actually refunded to the consumer as required by law. Under this approach, a replacement vehicle furnished by the dealership will be considered by the CDTFA to be a separate sale to the buyer and sales tax will be applicable to the full selling price of that vehicle. The dealership must report and remit the full sales tax applicable to the CDTFA at the time that the replacement vehicle is furnished.

Vehicle dealers involved in the above situations should retain documentation on file supporting these transactions (section 0616.20).

RESTITUTION OR REPLACEMENT

(CONT. 2) 0616.15

Example 1. Monetary Restitution — Method of calculating sales tax refund when the customer elects restitution in lieu of vehicle replacement.

The tax rate in effect at the time of purchase was 8.25%. The vehicle was driven 5,907 miles prior to the first nonconformity. Please note, this example does not take into account other types of manufacturer to customer reimbursements (e.g., finance charges, attorney fees, rental car, etc.).

Description	per Sales Contract (Original Vehicle)
Cash Price of Vehicle	\$22,100.00
Accessories	
Manufacturer Installed Options	500.00
Dealer Installed Options	150.00
Document Fee	45.00
Less: Usage	(1,112.49)
Dealer Installed Options	(150.00)
Subtotal	\$21,532.51
Sales Tax Refund	
(\$21,532.51 X 8.25%)	\$ 1,776.43
License Fee	183.00
Total	\$23,491.94

In this example, the manufacturer is required to reimburse the customer a minimum of \$23,491.94 as restitution. When the customer is fully reimbursed and all other applicable requirements of the Civil Code are met, the manufacturer may file a claim for refund with the CDTFA for the sales tax in the amount of \$1,776.43.

Usage Calculation – The customer is liable for use of the defective vehicle prior to the time the customer first delivers the vehicle to the manufacturer, or to its authorized service and repair facility for correction of the problem that gave rise to the nonconformity. The amount attributable to such use by the customer will be calculated by multiplying the total sales price of the motor vehicle by a fraction having as its denominator 120,000 and as its numerator the number of miles the vehicle was used by the customer, up to the first nonconformity.

$$\begin{array}{rcl}
 \text{Cash Price of Original Vehicle (X)} & \frac{\text{Miles Driven Prior to the First Nonconformity}}{120,000} & \\
 (\$22,100 + \$500) & \text{(X)} & \frac{5,907}{120,000} = \$1,112.49
 \end{array}$$

Dealer installed non-manufacturer options are not required to be reimbursed under the Civil Code.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

RESTITUTION OR REPLACEMENT

(CONT. 3) 0616.15

Example 2. Vehicle Replacement — Method of calculating sales tax due when the replacement vehicle has a value greater than the credit given for the original vehicle.

The tax rate of 8.25% was in effect at the time of both transactions, the replacement and the original purchase. The original vehicle was driven 5,907 miles prior to the first nonconformity. This example does not take into account other types of manufacturer to customer reimbursements (e.g., finance charges, attorney fees, rental car, etc.)

Description	Replacement Vehicle (Negotiated Price)	per Sales Contract (Original Vehicle)	Difference
Cash Price of Vehicle	\$28,500.00	\$22,100.00	\$6,400.00
Accessories			
Manufacturer Installed Options	855.00	500.00	355.00
Dealer Installed Options	200.00	150.00	50.00
Document Fee	45.00	45.00	0.00
Less: Usage		(1,112.49)	1,112.49
Dealer Installed Options		(150.00)	150.00
Subtotal	\$29,600.00	\$21,532.51	\$8,067.49
Sales Tax Due			
(\$8,067.49 X 8.25%)	665.57		665.57
License Fee	237.00	183.00	54.00
Total	\$30,502.57	\$21,715.51	\$8,787.06

In this example, the customer is entitled to a total credit of \$21,715.51 from the original sales contract. Since the value of the replacement vehicle was greater than the original vehicle, the customer would owe additional sales tax of \$665.57 on the additional taxable measure of \$8,067.49. The additional taxable measure of \$8,067.49 should be reported to the CDTFA along with the additional sales tax due of \$665.57 for the replacement vehicle for the period in which the replacement transaction takes place. Therefore, the manufacturer should not file a claim for refund on this transaction. The customer is responsible for paying the additional amount of \$8,787.06 to cover the additional cost of the replacement vehicle. The total allowable credit from the original vehicle applied towards the replacement vehicle is \$21,715.51.

Usage Calculation — The customer is liable for use of the defective vehicle prior to the time the customer first delivers the vehicle to the manufacturer, or to its authorized service and repair facility for correction of the problem that gave rise to the nonconformity. The amount attributable to such use by the customer will be calculated by multiplying the total sales price of the motor vehicle by a fraction having as its denominator 120,000 and as its numerator the number of miles the vehicle was used by the customer, up to the first nonconformity.

$$\begin{array}{rcl}
 \text{Cash Price of Original Vehicle (X)} & \frac{\text{Miles Driven Prior to the First Nonconformity}}{120,000} & \\
 (\$22,100 + \$500) & \text{(X)} & 5,907 \\
 & & \underline{120,000} \\
 & & = \$1,112.49
 \end{array}$$

Dealer installed non-manufacturer options are not required to be reimbursed under the Civil Code.

RESTITUTION OR REPLACEMENT

(CONT. 4) 0616.15

Example 3. Vehicle Replacement — Method of calculating the sales tax refund when the replacement vehicle has a value less than the credit given for the original vehicle.

The tax rate of 8.25% was in effect at the time of both transactions, the replacement and the original purchase. The original vehicle was driven 5,907 miles prior to the first nonconformity. This example does not take into account other types of manufacturer to customer reimbursements (e.g., finance charges, attorney fees, rental car, etc.)

Description	per Sales Contract (Negotiated Price)	per Sales Contract (Original Vehicle)	Difference
Cash Price of Vehicle	\$15,700.00	\$22,100.00	(\$6,400.00)
Accessories			
Manufacturer Installed Options	145.00	500.00	(355.00)
Dealer Installed Options	100.00	150.00	(50.00)
Document Fee	45.00	45.00	0.00
Less: Usage		(1,112.49)	1,112.49
Dealer Installed Options		(150.00)	150.00
Subtotal	\$15,990.00	\$21,532.51	(\$5,542.51)
Sales Tax Refund			
(\$5,542.51 X 8.25%)		457.26	(\$457.26)
License Fee	130.00	183.00	(53.00)
Total	\$16,120.00	\$22,172.77	(\$6,052.77)

In this example, the customer is entitled to a \$6,052.77 refund directly from the manufacturer as well as the replacement vehicle costing \$16,120.00 for a total credit amounting to \$22,172.77. When the customer is fully reimbursed and all other requirements of the civil code are met, the manufacturer may file a claim for refund with the CDTFA for the sales tax in the amount of \$457.26.

- **Usage Calculation** — The customer is liable for use of the defective vehicle prior to the time the customer first delivers the vehicle to the manufacturer, or to its authorized service and repair facility for correction of the problem that gave rise to the nonconformity. The amount attributable to such use by the customer will be calculated by multiplying the total sales price of the motor vehicle by a fraction having as its denominator 120,000 and as its numerator the number of miles the vehicle was used by the customer, up to the first nonconformity.

$$\begin{array}{rcl}
 \text{Cash Price of Original Vehicle} & (X) & \text{Miles Driven Prior to the First Nonconformity} \\
 & & 120,000 \\
 (\$22,100 + \$500) & (X) & 5,907 \\
 & & = \\
 & & \frac{\$1,112.49}{120,000}
 \end{array}$$

- **Dealer Installed Options** — Dealer installed non-manufacturer options are not required to be reimbursed under the Civil Code.

CLAIM FOR REFUND DOCUMENTATION REQUIREMENTS

0616.20

All claims for refund of sales tax by the manufacturer are forwarded to the Audit Determination and Refund Section (MIC: 39) and include a statement that the refund to the customer was made in accordance with Civil Code Sections 1793.2 through 1793.26. The claim must include an explanation of how the refund was calculated, including settlement agreements and odometer statements, along with proof that the retailer of the motor vehicle reported and paid sales tax on that vehicle. A statement from the selling dealer that sales tax was reported on the original sale of the vehicle will be accepted as adequate proof that tax was reported and paid. The following documents should also be provided in support of the refund claim:

1. A copy of the original sales agreement for the reacquired vehicle,
2. A copy of the replacement vehicle sales agreement (if applicable),
3. Copy of documents to support the claimed amount was refunded to the buyer and/or any financing entity holding title (e.g., check(s) issued),
4. The seller's permit number of the original retailer,
5. Beginning January 1, 1996, a copy of the branded title of the reacquired vehicle,
6. Proof that the decal the manufacturer is required to affix to that motor vehicle has been affixed,
7. Copies of refund computation worksheets, and
8. A copy of the repair history to support the number of miles driven prior to the first nonconformity.

An auditor may also request copies of arbitration documents if they are needed to establish the amount returned to the customer.

LEASING

0617.00

GENERAL

0617.05

One of the principal factors in determining the application of tax to leases is the type of vehicles involved. A distinction must be made between passenger cars and vehicles defined in the law as “mobile transportation equipment.” Both types of vehicles are defined in the following sections. Regulations 1660 and 1661 cover the application of the tax to leases.

**DEFINITIONS — VEHICLES OTHER THAN
MOBILE TRANSPORTATION EQUIPMENT**

0617.10

The following vehicles are not mobile transportation equipment (MTE) and are treated in the same manner as passenger cars for tax reporting purposes:

- a. **Passenger Vehicles**
Section 465 of the California Vehicle Code provides that a passenger vehicle is any motor vehicle, other than a motor truck or truck tractor, designed for carrying not more than 10 persons including the driver, and used or maintained for the transportation of persons.
- b. **Multi-Purpose Vehicles.** Vehicles registered as multi-purpose vehicles such as Jeep, Bronco, Blazer, Land Rover, Land Cruiser, are not MTE.
- c. House cars and motor homes.
- d. Motorcycles.
- e. Combination pickup and camper leased as a unit and registered with the DMV as a house car. If such vehicles are not registered as house cars they are regarded as MTE.
- f. Mini-buses or vans designed primarily for carrying persons, and limited in design to carrying not more than 10 persons including the driver, which are registered with DMV as passenger vehicles under the Vehicle Code. Those not so registered are regarded as MTE.
- g. Forklift trucks.
- h. Trailers and baggage containers designed for hauling by passenger vehicles.
- i. **One-Way Rental Trucks**
These vehicles are motor trucks of a kind required to be registered under the Vehicle Code, with a manufacturer’s gross vehicle weight rating not exceeding 24,000 pounds, which are principally employed by a person in the rental business in being leased out for short term periods of not more than thirty-one (31) days to individual customers for one-way or local hauling of personal property of the customers, and which upon acquisition or upon being employed in this state by the person, are identified to the CDTFA as one-way rental trucks by reporting tax measured by rental receipts on a timely return for the first reporting period in which the truck is leased, and by maintaining records which can be verified by audit of the vehicles as to which such an election has been made.
Upon the leasing of such a truck to a customer, the lessor shall make known to the customer the fact that the vehicle is designated as a one-way rental truck and shall make known to the customer any taxes which are payable measured by the rentals. Once a truck is identified to the CDTFA as a one-way rental truck, the election may not be revoked with respect to that truck. However, failure of the lessor to make such a timely election will cause such vehicles to be classified as mobile transportation equipment.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

APPLICATION OF TAX TO LEASES OTHER THAN OF MOBILE TRANSPORTATION EQUIPMENT

0617.15

The lease or rental of a vehicle not classified as MTE is a continuing sale and purchase during any period of time in which the vehicle is in this state unless tax or tax reimbursement has been paid timely measured by the purchase price of the vehicle and it is leased or rented in substantially the same form as acquired. If tax or tax reimbursement has not been so paid, and the lessor desires to pay tax measured by the purchase price, it must be reported and paid with the tax return for the period during which the property is first placed in rental service.

Leases or rentals which are continuing sales are subject to tax measured by the rental charges. Generally, the applicable tax is a use tax imposed upon the lessee which must be collected and paid to the state by the lessor when the rental charges are collected. When the lessee is not subject to use tax (e.g., insurance companies, the United States or its instrumentalities), the sales tax applies. The sales tax is upon the lessor and is measured by rentals payable.

Also, sales tax does not apply to the following:

- Sales to the United State government or its unincorporated agencies and instrumentalities.
- Sales to any incorporated agency or instrumentality of the United States owned wholly either by the United States or by a corporation wholly owned by the United States.
- Sales to the American National Red Cross, its chapters and branches.

Sales of vehicles to federally chartered banks exempt from state taxation under federal law, such as federal reserve banks, are exempt from sales tax. (See Regulation 1567)

The timely payment of tax or tax reimbursement measured by the purchase price of the vehicle constitutes an irrevocable election not to pay tax measured by rental receipts. This election may not be changed by reporting tax on rental receipts and claiming a tax paid purchase resold deduction for the tax paid on the purchase price. When tax or tax reimbursement has been paid timely measured by the purchase price of the vehicle that is leased in same form as acquired, the lessor may not collect an amount from the lessee designated as tax or tax reimbursement. If tax reimbursement is improperly collected on rental receipts, it must be returned to the lessee or paid to the state to the extent that it exceeds the tax liability measured by the purchase price.

DEFINITIONS — MOBILE TRANSPORTATION EQUIPMENT

0617.20

The following are classified as MTE:

- a. Trucks, Truck Tractors, Truck Trailers and Buses
- b. Pickup trucks, including such vehicles as Ford, Nissan, and Toyota pickups, etc. Even though pickup trucks are often thought of as passenger vehicles, they are in fact MTE and must be treated as such for tax purposes.
- c. Vehicles designed for carrying more than 10 persons, including the driver, are regarded as MTE and not passenger vehicles.(d) Panel trucks designed primarily for carrying property. Also, van equipped with a seat in the front only designed primarily for carrying property.
- d. Hearses
Tangible personal property which is or becomes a component of MTE.

AUDIT MANUAL

- e. **Bogies**

The term “bogie” means a vehicle consisting of an axle or axles with wheels and tires and a device mounted on its frame to support a container (van body) as an undercarriage. It acts as wheels for and in conjunction with the container (or van body). Bogies are specifically designed to couple under a container temporarily for highway use, being detachable when not required. Bogies may be designed and constructed to allow a sliding movement under a container (or van body) to several positions in order to adjust to the desired axle loading.
- f. **Chassis**

The term “chassis” means a frame with one or more axles designed to be used in conjunction with, and as a temporary support or undercarriage, for a container or other van-type box. The chassis and axle, or axles, may be designed and constructed to allow a sliding movement for extending the chassis to allow the carriage of various length bodies or to allow movement of one or more axles to any given position under the container. When operated as a semitrailer, the front portion of the container and chassis is attached to a motor vehicle or dolly.
- g. **Dollies**

The term “dolly” means a vehicle consisting of a tongue, fifth wheel, and axle equipped with wheels and tires to be connected to a semitrailer to support the front end of the semitrailer, including a portion of the cargo thereon, but which is not permanently attached to the semitrailer.
- h. **When coupled to the semitrailer by its fifth wheel (which is mounted on the frame) and to a trailer by the tongue, the semitrailer becomes in effect a “full” trailer. A dolly may also be designed and used as the third or rear axle of a two-axle tractor to act as an additional axle to support a portion of the weight of a towed semitrailer and any load thereon, thus reducing tractor axle loads. Pole, pipe, and logging dollies consist of a tongue, bolster and axle, or axles, equipped with wheels and tires. When connected to a motor vehicle by its tongue, or by the cargo, this type of dolly is used to transport long poles, timbers, logs, pipes or structural materials with the rear end of the cargo resting on the dolly bolster and the front end on the motor vehicle.**
- i. **Ships**

The term “ships” includes vessels such as trawlers, fishing boats, sailboats, and yachts which are 30 feet or more in length.
- j. **Aircraft**

The term “aircraft” includes contrivances designed for powered navigation in the air, except a rocket or missile. “Aircraft” also includes an airframe or a fuselage even without an engine.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

**APPLICATION OF TAX TO LEASES OF MOBILE
TRANSPORTATION EQUIPMENT**

0617.25

The sale of MTE to a lessor is a retail sale, and the lessor is the consumer of the equipment. Accordingly, either the sale of the equipment to the lessor or its use in this state may be subject to tax, unless the sale or use is exempt from tax. If the sale occurs within California, the transaction is subject to sales tax unless the lessor makes a timely election to report his or her tax liability measured by the fair rental value. On the other hand, if the sale occurs outside California and the property is purchased for use in California, use tax will apply measured by the purchase price, unless the lessor makes a timely election to report use tax based on the fair rental value.

Dealer and non-dealer lessors of MTE who cannot otherwise properly issue a resale certificate may issue such a certificate for the limited purpose of reporting their use tax liability based on fair rental value. This election must be made on or before the due date of the return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on a timely return for that period. Tax must thereafter be paid with the return for each reporting period, and measured by the fair rental value whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made. Fair rental value is normally regarded as the rentals required by the lease (even though not paid), except where the CDTFA determines the rental receipts are nominal. Tax on fair rental value does not apply either:

1. for periods during which the equipment is not leased and is merely held for lease; or
2. for periods after the lessor has formally demanded return of the equipment if the lessee wrongfully retains possession of the property and is not required to make rental payments under the lease.

Tax rate used for MTE leases (Regulation 1661(b)(2)(B)):

1. The applicable rate is the rate in effect at the time the equipment is first leased.
2. The rate will remain the same for all periods during which the equipment is leased including:
 - All periods during subsequent leases of the equipment.
 - During any period in which the tax rate is increased or decreased.

If lessor of MTE purchases such equipment under a resale certificate and collects tax reimbursement on the rental receipts, but pays no tax to the state, the lessor must pay tax on the purchase price of the equipment since a timely election to measure the tax by fair rental value was not made. The tax reimbursement collected on rental receipts is excess tax reimbursement and must be returned to the lessee or paid to the state. (see Regulation 1700 (b)(4) for offsets)

SPECIAL FACTORS WHEN TAX REPORTED ON RENTALS**0617.30**

When the tax liability is based on rental receipts, the following points must be considered for both MTE and passenger vehicles.

- a. **Registration of Vehicle**
Leased vehicles must be registered as prescribed by Section 4453.5 of the California Vehicle Code in the name of either the lessor or the lessor/lessee jointly. If vehicles are registered in the name of the lessee only, tax liability may not be measured by rental receipts, and the transaction will be regarded as a retail sale subject to tax. (See section 0607.15).
- b. **License Fees**
The license fees paid to DMV and included in a monthly lump sum charge made to lessees may be excluded from the rental charges subject to tax.
- c. **Late Charges**
Additional charges made by the lessor as a penalty for overdue rental payments are not a part of rental receipts subject to tax if they are reasonable charges for the cost of money or additional administrative expense.
- d. **Interest Payments**
Amounts designated by the lessor as interest, which the lessee must periodically pay along with amounts designated as rentals are part of rental receipts subject to tax.
- e. **Deficiency Charges**
Any deficiency amount the lessee is required to pay at the termination of a lease to satisfy the base rental must be included in rental receipts subject to tax. If the lessee is given credit for any amount paid in excess of the base rental such credit may be excluded from rental receipts subject to tax.
- f. **Insurance Charges**
Charges to the lessee for automobile insurance must be included in the rental charges subject to tax if the lessee is required to purchase the insurance from the lessor. However, if the lessee has an option to purchase the insurance from the lessor or an insurer of his or her own choice, the charges for the insurance, if separately stated, may be excluded from the rental charges subject to tax.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SPECIAL FACTORS WHEN TAX REPORTED ON RENTALS

(CONT.) 0617.30

g. Gasoline Furnished by the Lessor (Wet Rentals)

A “wet rental” is a lease of a vehicle in which the total rental charge includes gasoline furnished by the lessor. Whether the sale of the gasoline to the lessor is subject to sales or use tax depends on whether the lessor is the retailer or the consumer of the gasoline furnished.

When the lease of a vehicle is a continuing sale under the California Sales and Use Tax Law, the lessor is the retailer of gasoline furnished under wet rentals of the vehicles. Such gasoline may be purchased ex-tax under a resale certificate, and if sales or use tax is reported and paid on the total rental receipts no additional tax liability accrues.

When the lease of a vehicle is not a continuing sale because tax has been paid on the cost of the vehicle, or because the vehicle is mobile transportation equipment, the lessor is the consumer of gasoline furnished under a wet rental, and tax applies to the sale of the gasoline to the lessor. However, if the lessor makes a separate charge to the lessee for the gasoline, the lessor is the retailer of such gasoline and the retail sale of the gasoline is subject to sales tax. In that case, the lessor may purchase the gasoline ex-tax under a resale certificate. In the case, of a wet rental of mobile transportation equipment, where the lessor has properly elected to report his use tax liability measured by fair rental value, the use tax applies only to that portion of the rental charge attributable to the lease of the equipment.

h. Up Front Costs or Drive Away Charges

“Up front costs” or “drive away” charges that are generally subject to tax include capitalized cost reductions, document preparation charges, bank fees, acquisition fee, and booking fees. At the close of the lease, tax applies to charges such as renegotiation fees, assumption fees, deferral fees, and excessive wear and use charges (for example, excessive mileage fees). Refundable security deposits are not taxable when received by the dealer at the inception of the lease (tax does apply to the fee if it is applied to a taxable amount owed on the lease, when it is applied). Title and registration fees are also specifically excluded from tax. While late charges for late payments of leases are not subject to tax, late charges for failing to return the vehicle timely are subject to tax as it is a charge for the use of the vehicle. In virtually all retail motor vehicle lease transactions conducted by new and used motor vehicle dealers, the dealer is initially the owner of the leased vehicle and appears on the lease contract as the lessor. At the inception of the lease, the dealer generally collects from the lessee the first month’s lease and various other “up front” charges. Sometime after initiating the lease contract, the dealer may assign the lease contract to a third party. The dealer is responsible for collecting and reporting tax on all taxable costs for which payment was received from the lessee. The party to whom the contract is assigned is responsible for collecting and reporting tax on all subsequent lease payments after the lease is assigned.

**LOCAL USE TAX ALLOCATION ON LEASES
OF MOTOR VEHICLES****0618.00****GENERAL****0618.05**

Prior to January 1, 1996, use tax was reported by the lessor on Schedule B to the place of assumed use of the vehicle by the lessee. Generally, if the lease was short term (30 days or less), the local use tax was allocated to the business location of the lessor. If the lease was long term (over 30 days), the place of use was where the lessee resides. Effective January 1, 1996, the place of use for certain long-term leases of motor vehicles changed. As provided by Law Section 7205.1, the place of use for long-term leases (defined as longer than four months) shifted from the location of the lessee to the location of the new motor vehicle dealer.

Additional changes occurred to Law Section 7205.1 effective January 1, 1999. The following rules apply to leases entered into on or after January 1, 1999. For leases entered into prior to January 1, 1999, lessors should continue to allocate the local use tax as previously instructed (Operations Memo 1036 dated January 8, 1996 and Special Notices sent to taxpayers on 11/95 and 3/97). As a general rule, the local use tax on the lease of a new motor vehicle should be allocated based upon the location of the dealer.

Effective January 1, 1999, Law Section 7205.1 was amended to specify the proper allocation of local use tax collected by "leasing companies." For the purposes of the allocation of the 1% local tax, a "leasing company" is a motor vehicle dealer (as defined in Vehicle Code Section 285) that meets all of the following criteria:

- They originate long-term lease contracts and elect to remit tax based on lease receipts.
- They do not sell or assign the long-term contracts that they originate.
- They have annual motor vehicle lease receipts of fifteen million dollars (\$15,000,000) or more per location. Where the lessor operates from multiple locations, the lessor qualifies as a leasing company on a location-by-location basis. Annual lease receipts, which do not include capitalized cost reduction payments or amounts paid by a lessee to exercise an option, are calculated based on the previous calendar year.

A "leasing company" must be a motor vehicle dealer. The term "dealer" does not include a person who is solely engaged in the business of leasing.

When a lessor is a California new motor vehicle dealer or a "leasing company" as previously defined, the place of use for reporting the local use tax is the city in which the lessor's place of business is located.

When the lessor is not a California new motor vehicle dealer or a "leasing company," there are two possible allocations of the 1% local use tax. When the lessor purchases the vehicle from a California new motor vehicle dealer or a "leasing company," the place of use for reporting the local use tax is the city in which the dealer from whom the lessor purchased the vehicle is located. When the lessor purchases the vehicle from another source, the local use tax shall be reported and distributed through the countywide pool of the county in which the lessee resides.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

DETERMINING THE ALLOCATION OF LOCAL TAX

0618.10

The place of use for determining the allocation of the 1% local use tax for vehicle lease agreements entered into on or after January 1, 1999 is summarized by the following chart:

Guidelines for Allocating the Local Use Tax Due on Leases of Motor Vehicles Effective January 1, 1999

Type of Lessor		Leases Exceeding 4 months Allocate Local Tax To:	Leases for 4 months Or Less Allocate Local Tax To:
California New Motor Vehicle Dealer	Lease of a new or used motor vehicle.	Lessor's sales location (Schedule F not needed)	Lessor's sales location (Schedule F not needed)
California "Leasing Company" (as defined)	Lease of new or used motor vehicle.	Lessor's sales location (Schedule F not needed)	Lessor's sales location (Schedule F not needed)
California Lessor other than a New Motor Vehicle Dealer or "Leasing Company" (as defined)	Lease of a motor vehicle purchased from a California new motor vehicle dealer or qualifying "leasing company."	California new motor vehicle dealer or "leasing company's" sales location (Schedule F)	Lessor's sales location (Schedule F not needed)
	Lease of motor vehicle, other than one purchased from a California new motor vehicle dealer or qualifying "leasing company."	Lessee's place of residence (Schedule B)	Lessor's sales location (Schedule F not needed)
	Lease of MTE, other than a light duty pickup truck, purchased from a California new motor vehicle dealer or qualifying "leasing company."	Lessor's sales location (Schedule F not needed)	Lessor's sales location (Schedule F not needed)
Out-of-State Lessor:	Lease of motor vehicle purchased from California new motor vehicle dealer, or qualifying "leasing company" (as defined).	California new motor vehicle dealer or "leasing company's" sales location (Schedule F)	Lessee's place of residence (Schedule B)
	Lease of motor vehicle and MTE, other than one purchased from a California new motor vehicle dealer or qualifying "leasing company."	Lessee's place of residence (Schedule B)	Lessee's place of residence (Schedule B)

- Traditional passenger vehicle (designed to carry, including the driver, no more than 10 passengers), but not including any mobile transportation equipment except light duty pickup trucks rated less than one ton.
- "Leasing company" is defined in Section 0618.05.

For leases allocated to a California dealer's sales/business location, the place of use for local use tax purposes remains the same for the duration of the contract, even though the lessor may sell the vehicle and assign the lease contract to a third party.

The provisions of Section 7205.1 relates to new motor vehicle dealers do not apply to leases entered into on or before December 31, 1995. The provisions of Section 7205.1 relates to leasing companies do not apply to leases entered into on or before December 31, 1998. The local use tax on these leases continues to be allocated to Schedule B.

TRANSACTIONS (SALES) AND USE TAX**0620.00**

a. General.

If a vehicle, aircraft or undocumented vessel is licensed or registered in any district imposing the tax, the retailer is considered engaged in business in that district and is required to collect the use tax and pay it to the state.

- b. If the dealer is located in a special tax district and sells or leases a vehicle that will be registered in an area where there is no special district tax, the dealer is required to obtain a signed declaration from the purchaser indicating where the vehicle will be registered.

Delivery to a point outside the district shall be satisfied for purpose of the transaction (sales) tax as follows:

1. With respect to vehicles (other than commercial vehicles) subject to registration pursuant to Chapter 1 (commencing with Section 4000) of Division 3 of the Vehicle Code, aircraft licensed in compliance with Section 21411 of the Public Utilities Code, and undocumented vessels registered under Division 3.5 (commencing with Section 9840) of the Vehicle Code by registration to an out-of-district address and by a declaration under penalty of perjury, signed by the buyer, stating that such address is, in fact, the principal place of residence, and
2. With respect to commercial vehicles by registration to a place of business outside the district and a declaration under penalty of perjury, signed by the buyer, that the vehicle will be operated from that address.

For sample declarations used for commercial vehicles and for noncommercial vehicles see Regulation 1823.5, *Place of Delivery of Certain Vehicles, Aircraft and Undocumented Vessels*. Although the dealer is not required to use the sample declarations shown in the Regulation, any declaration used must contain the same information.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

**NEW OR REMANUFACTURED TRUCKS,
TRUCK TRACTORS, TRAILERS, OR SEMITRAILERS**

0625.00

TRUCK MANUFACTURERS — GENERAL

0625.05

Several major truck manufacturers maintain factory branches within the state. These act as both distributors and dealers. Their records do not conform with any of those described in the preceding sections, nor do their methods of reporting sales tax liability follow any set pattern.

Sales made by the in-state branches, out-of-state branches, the home office, and the factory will be subject to sales tax in some cases and to use tax in other cases.

The auditor should be familiar with the entity regarding the locations of factories, divisions, home office and permits. The auditor should also review the sales tax working papers in detail for inclusion of sales by other than the local branch. Discussion with branch manager, sales manager and other key personnel will give the auditor a better understanding of any audit problems that need to be resolved. It is very possible that the audit will be or should be controlled by the Out-of-State Field Office. As soon as it is determined that work is to be done out-of-state, the Out-of-State Field Office should be notified. The auditor, in addition to reconciling the recorded and reported liability, should review correspondence files, inter-branch and the home office accounts and statements, internal billings and warranty charges to home office.

Audits of truck manufacturers should be quite detailed, since no one reporting period will prove typical of the operations of the retailer for the audit period.

The auditor should also be alert to the leasing operations of truck manufacturers. Leases should be carefully examined to determine the status of truck tractors, trailers, trucks, and dollies. (See section 0625.15.)

TRUCKS AND TRAILERS SOLD BY OUT-OF-STATE RETAILERS

0625.10

The sale of a new or remanufactured truck, truck tractor, trailer, or semi-trailer, any of which has an unladen weight of 6,000 pounds or more, new or remanufactured trailer coach, or new or remanufactured auxiliary dolly to a purchaser in California is exempt from sales and use tax when the vehicle is delivered to the purchaser in California by the manufacturer or remanufacturer pursuant to a retail sale by an out-of-state dealer and certain conditions provided by section 6388 of the Revenue and Taxation Code (Regulation 1620.1(b)(2)) are present. This exemption typically shows up in audits of vehicle manufacturers or remanufacturers who deliver a vehicle [as defined in subdivision 1620.1(a)(8) "vehicle" includes certain trailers] to a purchaser who is not a resident of California for use exclusively in out-of-state or foreign commerce, when the purchaser:

1. Purchases the vehicle from a dealer located outside California,
2. Removes the vehicle from California within 30 days from the date of delivery,
3. Provides an affidavit to the manufacturer or remanufacturer, stating:
 - a. The name and location of the out-of-state dealer from whom the vehicle was purchased,
 - b. The name and location of the in-state manufacturer or remanufacturer that delivered the vehicle to the purchaser and the date of delivery,
 - c. That the purchaser is not a resident of California,
 - d. That the vehicle was purchased for use exclusively outside California,
 - e. That the vehicle was removed from California within 30 days of the delivery date, and
 - f. The date of removal.
4. Provides evidence of out-of-state vehicle registration [state of registration, license plate number and Vehicle Identification Number (VIN) or serial number] to the manufacturer or remanufacturer within 60 days of providing the affidavit to the deliverer.

To file the affidavit, the purchaser should use form CDTFA-837, *Affidavit for Section 6388 or 6388.5 Exemption from the California Sales and Use Tax*, (published on the CDTFA's website). Alternative documentation is permissible as long as it contains all the information required by form CDTFA-837.

Audits of vehicle manufacturers and remanufacturers: Manufacturers and remanufacturers should have an affidavit and registration documentation on file to support a claimed exempt transfer of a vehicle. Note: It is rebuttably presumed that a vehicle registered outside California and apportioned for use within California is not purchased for use exclusively outside California.

Audits of purchasers: The CDTFA may audit purchasers claiming exemption under Regulation 1620.1(b)(2). Under this exemption, purchasers must maintain internal records documenting that the qualifying vehicle was taken out of California within the time mandated by statute and was used exclusively outside California. Examples of documentary evidence are bills of lading showing the first functional use of the vehicle, vehicle logs/reports, fuel receipts, hotel bills, and copies of license or registration fee receipts showing the date of payment. Purchasers should also be able to prove residency outside California.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

TRAILERS SOLD FOR USE OUT-OF-STATE OR IN INTERSTATE OR FOREIGN COMMERCE

0625.15

Section 6388.5 of the Revenue and Taxation Code (Regulation 1620.1(b)(3)) exempts from tax the sale and use of a new or remanufactured trailer or semi-trailer with an unladen weight of 6,000 pounds or more provided the trailer is for use exclusively outside California or exclusively in interstate or foreign commerce or both and is delivered to a purchaser in California by an out-of-state or California manufacturer, remanufacturer or dealer pursuant to a sale by an out-of-state or California dealer. This exemption typically shows up in audits of trailer manufacturers or remanufacturers, dealers, or purchasers. To qualify for exemption, the purchaser must use the trailer exclusively in interstate, out-of-state, or foreign commerce and meet the following criteria:

1. A trailer that is manufactured or remanufactured outside California must be removed from California within 30 days from the date of delivery; or a trailer that is manufactured or remanufactured within California must be removed from California within 75 days from the date of delivery.
2. If the trailer is registered outside the state, the purchaser or purchaser's agent provides the delivering manufacturer, remanufacturer, or dealer a copy of the current out-of-state license and registration for the trailer showing the VIN or serial number; or, if the trailer is registered in-state under the PTI (Permanent Trailer Identification) program, the purchaser or purchaser's agent provides the delivering manufacturer, remanufacturer, or dealer a copy of the federal document assigning or confirming the purchaser's or lessee's USDOT (United States Department of Transportation) number, FMC (Federal Maritime Commission) number, or a copy of the current SSRS (Single State Registration System) filing with the DMV. A purchaser or purchaser's agent may not use an FMC number if the purchaser has a current USDOT number. Evidence of registration outside California must be submitted to the dealer, manufacturer, or remanufacturer no later than 60 days after the timely providing of an affidavit described in subdivision 1620.1(b)(3)(A)3. Evidence of a USDOT number, FMC number, or SSRS filing must be submitted with the affidavit. [Descriptions of the PTI, USDOT, FMC, and SSRS programs are included in Regulation 1620.1(a).]
3. The purchaser or purchaser's agent must also provide a valid affidavit to the manufacturer, remanufacturer, or dealer, stating:
 - a. The name and location of the dealer from whom the trailer was purchased,
 - b. The name and location of the California dealer, manufacturer or remanufacturer that delivered the trailer to the purchaser and the date of delivery,
 - c. That the vehicle was purchased for use exclusively outside the state, or exclusively in interstate or foreign commerce, or both,
 - d. That the vehicle was removed from the state within the appropriate time periods provided for in subdivision 1620.1(b)(3)(A)(1), and
 - e. The date of removal.

As noted in the previous section, the purchaser must use form CDTFA-837 or its equivalent as the affidavit.

AUDIT MANUAL

TRAILERS SOLD FOR USE OUT-OF-STATE OR IN INTERSTATE OR FOREIGN COMMERCE

(CONT.) 0625.15

Audits of purchasers: Purchasers of trailers under this exemption must maintain adequate records documenting that the qualifying trailer was taken out of California within the mandated time and was used exclusively in out-of-state, foreign or interstate commerce. Examples of documentary evidence are bills of lading (also indicating the first functional use of the vehicle), vehicle logs/reports, fuel receipts, hotel bills, and copies of license or registration fee receipts showing the date of payment.

Note: the exemption under 1620.1(b)(3) only applies to trailers and semitrailers — it does not apply to trucks or truck tractors..

TRUCKS AND TRAILERS SOLD TO LESSORS OF MOBILE TRANSPORTATION EQUIPMENT

0625.20

The sale of trucks and truck type trailers (excluding “one-way rental trucks” as defined in section 6024) to lessors is a retail sale subject to tax, and the use of the MTE by the lessee is not subject to tax since the lessor is the consumer.

Dealer and non-dealer lessors of mobile transportation equipment who cannot otherwise properly issue a resale certificate may issue such a certificate for the limited purpose of reporting their use tax liability based on fair rental value.

**FARM EQUIPMENT AND MACHINERY— PARTIAL
EXEMPTION**

0626.00

GENERAL

0626.05

Effective September 1, 2001, Section 6356.5 of the Revenue and Taxation Code partially exempts from sales and use tax the sale, storage, use, and other consumption in this state, of farm equipment and machinery (including qualified vehicles), purchased for use by a qualified person in a qualified manner. The partial exemption is for the state portion of the sales and use tax rate. See Regulation 1533.1.

QUALIFIED VEHICLES

0626.10

Regulation 1533.1(b)(1) includes in the term “farm equipment and machinery,” any new or used vehicles designated as implements of husbandry in the Vehicle Code. Vehicle Code section 36000 provides that an “implement of husbandry” is a vehicle used exclusively in the conduct of agricultural operations. This section also provides that an “implement of husbandry” does not include vehicles designed primarily for transportation of persons or property on the highway, unless specifically designated as such by other provisions of the Vehicle Code, as in section 36005.

Vehicle Code section 36005 provides a list of vehicles that qualify as “implements of husbandry.” This list is attached to Regulation 1533.1 as Appendix A. The list includes certain vehicles designed to transport persons or property on a highway although the Vehicle Code section 36000 excludes such vehicles as implements of husbandry. However, it should be noted that this section limits the vehicles’ on highway use to short distances, usually no more than two (2) miles or as otherwise indicated.

There are occasions when vehicles not specifically identified in Appendix A may qualify as farm equipment and machinery for the purposes of the partial exemption. This determination is made by the Department of Motor Vehicles’ (DMV) Special Processing Unit and is based on a review of the vehicle’s use and equipment requirements. If the DMV determines a vehicle qualifies as an implement of husbandry, it will issue a registration designating the vehicle as such and Special Equipment (SE) plates for the vehicle.

Depending on their use, unlisted vehicles such as All Terrain Vehicles (ATV) and agricultural aircraft (crop dusters) may qualify for the partial exemption. For example, an ATV may qualify when used exclusively by an agricultural operation to traverse an agricultural property to check fencing, round up livestock, check cattle and crops, examine watering and irrigation systems or similar activities required in an agricultural operation. When used exclusively for these purposes, the purchase of the ATV qualifies for the partial exemption provided all other requirements of Regulation 1533.1 are met. Similarly, crop dusters used exclusively for seeding, fertilizing, and crop protection will qualify for the partial exemption.

QUALIFIED PERSON**0626.15**

To qualify for section 6356.5 partial exemption, a purchaser must be a “qualified person” or “a person that assists a qualified person.”

“A qualified person” must be engaged in an agricultural operation described in Standard Industry Classification (SIC) Codes 0111 to 0291 or perform activities described in SIC Codes 0711 to 0783 in addition to being engaged in a line of business described in SIC Codes 0111 to 0291. SIC Codes 0111 to 0291 describe businesses that are engaged in farming and ranching. SIC Codes 0711 to 0783 describe businesses that are engaged in agricultural services to be limited to soil preparation, crop services, harvesting, veterinary, animal, farm labor and landscape services.

“A person that assists a qualified person” who performs an agricultural service described in SIC Codes 0711 to 0783 as an employee or on a contract or fee basis, also qualifies for the partial exemption, as explained in Regulation 1533.1(b)(3)

The following examples illustrate the concept of a “qualified person” and a “person that assists a qualified person.”

Example 1: Farmer Bob decides he isn't going to do his own fertilizing this year. Farmer Bob contracts with The Giant T'Mater Fertilizing Company to fertilize his tomatoes this year. Since this is a big contract, The Giant T'Mater Fertilizing Company decides to buy a new qualifying fertilizer applicator rig for use exclusively in agricultural operations. The Giant T'Mater Fertilizing Company performs agricultural services described in SIC code 0711, soil preparation services, and therefore qualifies as a person that assists a qualified person. The Giant T'Mater Fertilizing Company should give a partial exemption certificate for their purchase of the qualifying equipment.

Example 2: Farmer Bob's mom is ill, so next year he will contract out the management of the farm to Bestfriend Farm Management Co. Bestfriend Farm Management Co. buys a used qualifying All Terrain Vehicle (ATV) for use exclusively in getting around on the farm property and to check irrigation machines. Bestfriend Farm Management Co. is a person that assists a qualified person, (SIC 0762) and therefore qualifies for the partial exemption. If the use of the ATV in agricultural operations was less than 100%, Bestfriend Farm Management Co. would not qualify for the partial exemption.

Example 3: Citizen Jeff works a vegetable patch in his extra large backyard. The produce he doesn't consume he gives to his friends and family. He occasionally sells extra produce at a roadside stand, but does not report such sales and expenses on his federal income tax return. He noticed an otherwise qualifying vehicle for sale in the local newspaper and purchased it. Citizen Jeff is not a qualified person for purposes of the partial exemption because Citizen Jeff is growing produce for his own use and is not engaged in a business for purposes of Regulation 1533.1.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

PROOF OF EXEMPTION

0626.20

When a qualified person or a person that assists a qualified person purchases a qualified vehicle from a California dealer, that person should give a partial exemption certificate to the California dealer. The purchaser is not required to use the recommended partial exemption certificate (Regulation 1533.1) as long as the certificate provided by the purchaser has all of the elements for the partial exemption certificate outlined in Regulation 1533.1(c)(3).

When the seller is other than a California dealer, for example, an out-of-state vehicle dealer or an in-state non-retailer, the purchaser must do either one of the following:

OPTION 1: Pay the full amount of use tax to the Department of Motor Vehicles (DMV) and apply for a refund of the state exempted portion directly from the CDTFA.

OPTION 2: Pay the non-exempt portion of the tax to the CDTFA (Consumer Use Tax Section or a field office) and obtain a CDTFA-111, *Certificate of Tax Clearance*, for use in the registration with DMV.

Purchasers who report use tax or claim a refund from the CDTFA must provide evidence of being engaged in one of the required SIC codes. Acceptable documentation includes current federal income or state franchise tax returns that include Schedule F. If the purchaser did not file a Schedule F, staff should check the North American Industry Classification System (NAICS) code on the return to ensure it matches one of the activities qualifying for the partial exemption. If staff has questions concerning the eligibility of a NAICS code, a cross-reference between the SIC codes and the NAICS codes can be found at <https://www.census.gov/naics/>.

It is possible a person that assists a qualified person will not have a NAICS code that matches one of the activities qualifying for the partial exemption. If the purchaser cannot provide a Schedule F or appropriate NAICS code, other documentation, such as employment or service contracts, may be accepted.

AUDITOR'S RESPONSIBILITY

0626.25

Audits of California Dealers

The auditor must ascertain that a dealer's claimed section 6356.5 partial exemptions are supported by a valid partial exemption certificate obtained by the dealer timely and in good faith (Regulation 1533.1(c)(3) and (c)(5)) and are in connection with the sales of qualified vehicles. If the auditor suspects that the purchaser who issued the partial exemption certificate is not a qualified person or a person that assists a qualified person, or is not using the vehicle in a qualified manner as the purchaser claims in the partial exemption certificate, the auditor must contact the purchaser to verify the purchaser's and vehicle's eligibility for the partial exemption. If the auditor determines that the purchaser or the vehicle is not eligible for the partial exemption, the auditor should explain the proper application of tax and issue a billing against the purchaser. If the purchaser is located outside the area of the field office conducting the audit, the auditor should prepare a CDTFA 1164 for investigation by the purchaser's office of account.

Audits of Purchasers

The auditor must establish that the purchaser is a qualified person or a person that assists a qualified person and that the vehicle qualifies for the partial exemption as outlined in Regulation 1533.1. The auditor should examine the purchaser's state or federal income tax returns and other written documents such as contracts and invoices (refer to section 0626.20).

VESSEL DEALERS**0630.00****GENERAL****0630.05**

Persons wishing to secure manufacturer or dealer vessel registration numbers, “dealers plates,” from DMV are required under Division 3.5 of the Vehicle Code to make application to DMV. Applicants for these “dealer plates” must complete DMV form BOAT 101A and indicate their Seller’s Permit Number. “Dealer plates” are not issued for a specific vessel. The CF (vessel registration) number ends in DA to DZ for dealers and MA to MY for manufacturers. DMV will check with the Consumer Use Tax Section (CUTS) to determine if the seller’s permit is valid and that the person is regularly engaged in the sale of vessels. If the permit is not valid or the person does not appear to be engaged in the vessel business, the application will be returned advising the applicant to contact the nearest CDTFA office to resolve the problem.

DEFINITION**0630.10**

1. Vessel.

A vessel is defined in section 6273, of the Sales and Use Tax Law, as any boat, ship, barge, craft, or floating thing designed for navigation in water except:

- A sea plane,
- A watercraft designed to operate on a permanently fixed course, the movement of which is restricted to or guided on such permanently fixed course as outlined in section 6273,
- A watercraft designed to be propelled solely by oars or paddles,
- A watercraft of eight feet or less in length designed to be propelled by sail.
- A motor or other component of a vessel, whether or not detachable, is considered part of the vessel when sold as part of the vessel.

2. Documented Vessel.

A documented vessel is a vessel documented by the United States Coast Guard and is issued a valid marine certificate. All commercial vessels of five net tons or more are required to be documented. Pleasure vessels meeting the size requirements may be documented at the owner’s option. Vessel documentation is a world wide registration system in lieu of all other registration requirements. Documented vessels normally exceed thirty feet (30’) in length and accordingly are MTE.

3. Undocumented Vessel.

Any vessel which is not required to have, and does not have, a valid marine certificate issued by the United States Coast Guard is an undocumented vessel. Under the Federal Boating Safety Act, an undocumented vessel must be registered in the state where principally used on the waters. DMV registers undocumented vessels for the State of California as an agent of the Department of Boating and Waterways.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

DEFINITION

(CONT.) 0630.10

All undocumented vessels are issued a vessel registration number which must be displayed on the vessel. Registration numbers start with an abbreviation of the state such as CF for California, NV for Nevada, OR for Oregon and AZ for Arizona. All numbers read CFXXXXXX with the middle four numeric and the last two alpha characters. The following are examples of the registration number types when the last two alpha characters are as follows:

DA—DZ	Dealer
MA—MY	Manufacturer
LA, LB and LD	Livery (rental) boats and boats carrying paying passengers.
LC	Livery (rental) boats owned by a city or county.
MZ	Special use other than dealer or manufacturer.
XC	Boat of a city, county, district, or other municipality.
XF	Federal boats.
XS	State boats.
YB	Boats owned by certain youth groups.

4. Vessel Dealer.

A vessel dealer is a person required to hold a seller's permit by reason of the number, scope, and character of his or her sales of vessels.

5. Vessel Agent.

DMV, upon request, appoints agents to conduct registration of undocumented vessels. The official title of such agents is "Undocumented Vessel Registration Agent." Any licensed yacht and ship broker acting as an authorized agent of DMV may collect and remit use tax on a vessel transfer when applicable. Used vessel brokers are required to be licensed with the Department of Boating and Waterways.

SOURCE DATA

0630.15

The major sources of information on vessel transfers are the DMV and the U.S. Coast Guard. The CDTFa has an interagency agreement with the DMV covering undocumented vessels. Quarterly the CDTFa receives a CD-ROM containing the U.S. Coast Guard master registration file of documented vessels. The current data is compared to the data of the previous quarter to determine transfers in ownership of vessels documented with California addresses (which includes hailing ports and previous owners address and hailing port in California). Under the Foreign Registered Vessel and Aircraft Program (FRVAP), representatives of CUTS investigate records in county assessor offices to discover additional leads. Copies of documented vessel referrals are also forwarded to the appropriate county assessor for property tax purposes.

APPLICATION OF TAX ON SALE AND PURCHASE OF VESSELS

0630.20

Every sale or purchase of a vessel is subject to either sales tax or use tax, unless specifically exempt. Every sale of a vessel is a sale at retail, and by definition, the seller is a retailer. Vessels 30 feet in length or more generally are mobile transportation equipment. Sales by the vessel dealer, unless specifically exempt, are subject to sales tax if made in California. Sales by all other permit holders or private parties, unless specifically exempt, are subject to use tax payable by the purchaser to DMV at the time of registration for undocumented vessels and directly to the CDTFa for documented vessels.

AUDIT PROCEDURES**0630.25**

For undocumented vessel sales, a vessel dealer will prepare a DMV form BOAT 110, "Vessel Dealer or Manufacturer's Sales Tax Certification" and Boat 101, "Application for Registration Number Certificate of Ownership and Certificate of Number for undocumented Vessel." The Boat 110 certificate contains information identifying the vessel, the purchaser, the dealer (including permit number), the selling price and sales tax, and a signed certification that the applicable taxes on the sale will be reported directly to the CDTFA.

CUTS sorts by office the completed forms and forwards the forms to the appropriate field office for further handling.

During an audit of a watercraft dealer or dealer/broker, the auditor shall prepare a CDTFA-379-B on all properly supported exempt sales of vessels sold for over \$10,000 involving:

1. Yacht and Ship Brokered Transactions
2. Out-of-State Deliveries — The Three-Mile Limit (Law Section 6247)
3. Regulation 1594 Exemption Claims (commercial deep sea fishing, offshore drilling platform and interstate and foreign commerce)

However, the auditor should perform sufficient verification to ensure that no transactions are listed which are properly the liability of the taxpayer under audit, i.e., list only transactions which audit verification strongly suggests are the responsibility of the purchaser. CUTS account information is available through the system's Consumer Use Tax Maintenance Screen (CUT MA) and may aid in the resolution of these transactions.

For categories 2 and 3 transactions, staff should be certain that the dealer has not in effect encouraged false certificates. If it can be established that the dealer knew the facts stated in the certificate were not true, the tax plus applicable interest and penalties should be assessed against the dealer. A dual determination against the purchaser might be justified in some situations.

All forms prepared on these transactions should contain as much information as possible but should include as a minimum: The name and address of purchaser; type of watercraft including make, size, and description; state of registry or documentation; place of delivery; selling price; and the basis upon which the transaction was claimed as exempt, e.g., brokerage, out-of-state delivery or Regulation 1594. A photocopy of the exemption certificate and invoice, if available, should be attached to the CDTFA-379-B.

Completed CDTFA-379-B's should be forwarded directly to CUTS. CUTS will correlate this data with any other available information and verify the claim.

YACHT AND SHIP BROKERS**0630.30**

Yacht and ship brokers are not required to collect use tax on sales made on behalf of their clients. Therefore, when a vessel dealer also acts in the capacity of a broker, a distinction has to be made between retail sales and brokerage sales. A brokerage sale is defined as a sale handled by a representative in which the representative does not by his/her own act bind the principal to the contract or transfer title of the vessel to the buyer. The Department of Boating and Waterways licenses yacht and ship brokers and their salesmen. The Department of Boating and Waterways does not, however, license new vessel dealers. Lists of licensees are available through Department of Boating and Waterways. However, brokerage sales by unlicensed persons do occur.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

YACHT AND SHIP BROKERS

(CONT.) 0630.30

Effective January 1, 1996, section 6202 of the Revenue and Taxation Code was amended to provide that a person's liability for use tax is relieved when that person purchases a vessel through a broker if the purchaser has paid an amount specified as sales or use tax to the broker and obtains a receipt showing the payment of the tax. In this case, the broker is liable for that amount under Law section 6204 as if the broker were a retailer engaged in business in this state, and the amount collected constitutes a debt owed by the broker to this state. The purchaser is relieved of the use tax only up to the amount collected by the broker.

The term "Net Sale" (often used interchangeably with "Consignment Sale") usually includes a base price placed on a vessel by the owner and anything received above the base price represents the "commission" for the broker. A net sales transaction does not involve the offer-and-acceptance procedure common to most brokerage transactions, and the broker has the ability to transfer title. Although net sales transactions require licensing under the Yacht and Ship Brokers Act, they are not brokerage transactions under provisions of the California Revenue and Taxation Code. Brokers regularly making "net sales" are required to hold a permit and pay sales tax measured by the gross receipts, the total amount of sale including commission, since the commission is taxable.

Over one-half of the boats sold through a broker are on or sold with a trailer. Persons who negotiate for the sale of boat trailers are considered dealers under the California Vehicle Code. Generally, boat trailers are treated as vehicles under the California Vehicle Code. However, brokers who sell trailers do not have dealer status in the Vehicle Code. Brokers should not use a "Notice of Sale" form to handle brokered trailer transfers. The form is only used by licensed dealers for sales tax transactions.

Its important to note that brokers who are acting as vessel agents (section 9858.5 CVC) may collect use tax for transmittal to DMV.

OUT-OF-STATE DELIVERY

0630.35

Sales tax does not apply to sales of vessels qualifying as sales in interstate commerce as described in Regulation 1620. Sales of vessels delivered out-of-state (e.g., outside three-mile limit) when title has not passed before delivery, that are brought back into California are regarded as having been purchased for use in California if their first functional use is in California. If, instead, the vessel is first functionally used outside California, the vessel is presumed to have been purchased for use in California if it is brought into California within 90 days after its purchase (exclusive of shipment or storage for shipment time), unless the vessel is used or stored outside California one-half or more of the time during the six-month period immediately following its entry into this state. Prior out-of-state use not exceeding 90 days from the date of purchase to the date of entry into California (exclusive of shipment or storage for shipment time) is considered of a temporary nature and is not proof of an intent that the vessel was purchased for use outside California.

OUT-OF-STATE DELIVERY**(CONT.) 0630.35**

Audits of Dealers: Auditors must verify that the dealer has documentation to substantiate that the vessel was delivered out-of-state, and that title did not pass to the purchaser in-state prior to delivery. Documentation may include:

1. A bill of sale, purchase agreement or other contract stating the terms of delivery of the vessel and transfer of title, which is signed by both the seller and the purchaser prior to delivery.
2. A contract or agreement showing that the person making delivery is acting as an agent for the dealer or seller, and not as an agent for the purchaser.
3. Documents verifying out of state delivery. Documents should clearly show the date and location of delivery and should be signed by the seller. A copy of the ship's log showing the trip. If delivery was made by a broker, the seller's authorization for the broker to deliver the vessel out-of-state must be provided.
4. If the purchaser is a known California resident, a statement signed under penalty of perjury by the purchaser stating that the vessel is not being purchased for use in California and that if the vessel enters California within 90 days of purchase (excluding time of shipment and storage for shipment), it will be used outside of California for more than one-half of the six-month period immediately following its entry into the state (section 6247).

Auditors are to prepare a CDTFA-379-B on all properly supported exempt sales over \$10,000.

Audits of Consumers: CUTS is responsible for verifying purchasers of vessels claiming an exemption for "Not Purchased for Use in California." CUTS requests documentation directly from the purchaser, including:

1. A bill of sale, purchase agreement or other contract stating the terms of delivery of the vessel and transfer of title, which is signed by both the seller and the purchaser prior to delivery.
2. Documents verifying out-of-state delivery. Documents should clearly show the date and location of delivery and should be signed by the seller. A copy of the ship's log showing the trip. If delivery was made by a broker, the seller's authorization for the broker to deliver the vessel out-of-state must be provided.
3. Copies of insurance documents for the vessel identifying the date insurance coverage began.
4. Confirmation of the location and use of the vessel for the entire period claimed. These documents must be dated and identify the vessel by name or documentation number, and may include mooring receipts, gasoline purchases, repair labor or parts receipts, or any other documentation supporting the purchaser's claim.
5. Copy of U.S. Customs Entry Collection Receipt or Informal Entry (Form 368).

NOTE: Although the Channel and Farallon Islands are not considered to be outside the three-mile limit, there is a stretch of water between the coast of California and these islands that qualifies as being outside the three-mile limit.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

REGULATION 1594 EXEMPTIONS

0630.40

Tax does not apply to the sale of, nor the storage, use, or other consumption of vessels used in commercial deep sea fishing operations, offshore drilling platforms or interstate and foreign commerce if they meet the requirements outlined in Regulation 1594. Sales of vessels may be exempt under Regulation 1594 provided that more than 50 percent of the total use during the test period is of an exempt nature. The exemption does not extend to the vessel trailer or a spotter plane. The exemption does include repair parts or tangible personal property becoming a component part of the exempt watercraft.

Audits of Dealers: Auditors need to verify that dealers making these types of exempt sales of vessels obtain and retain a completed Watercraft Exemption Certificate (See Regulation 1594).

Audits of Consumers: CUTS is responsible for verifying purchasers of vessels claiming an exemption under Regulation 1594 are entitled to the exemption. Documentation is requested directly from the purchaser by CUTS. The most common exemption claimed is for commercial deep sea fishing (section 0630.45)

COMMERCIAL DEEP SEA FISHING VESSELS

0630.45

Tax does not apply to sales of, nor to the storage, use, or other consumption of vessels used in commercial deep sea fishing operations provided that (1) more than 50 percent of the total use of the vessel during the first twelve months (after the first functional use) is in commercial deep sea fishing, (2) its principal use is outside the three-mile limit, and (3) gross receipts from commercial deep sea fishing operations total at least \$20,000 in a selected 12-month period (as discussed below). See Regulation 1594.

With respect to watercraft, there is a rebuttable presumption that “persons who are regularly engaged in commercial deep sea fishing” do not include persons who have gross receipts from deep sea fishing operations inside or outside the territorial waters of this state totaling less than \$20,000 in a 12-month period. (Please note: the 12-month \$20,000 figure is used prospectively with the first functional use by a new commercial fisherman, but any consecutive 12-month period which includes the first operational use of the vessel, may be used retroactively for a person regularly engaged in commercial fishing.)

When a person secures a commercial fishing license, a book of fish receipts is issued so the person can give receipts to people who purchase the fish, other than wholesalers, and all landings must be reported to Fish and Game regardless of the fact they total less than 100 pounds. A separate license is required for the vessel. Though voluminous documentation is not mandatory to prove the major catch location, prudence should be exercised when considering the claim. The type of vessel and the location of its home port are good indicators and if necessary, the log of the vessel and/or the permit which must be obtained by the owner to sell fresh fish might be examined.

The kind of fish sold may be more indicative of the location of the vessel's use. For example, abalone dive boats generally stay within the three-mile limit, while albacore fishermen operate well beyond the three-mile limit. A letter is sent by CUTS to the taxpayer when a commercial deep sea fishing exemption is claimed. The letter lists all of the documentation needed to prove the sale of the vessel is exempt.

Additionally, there is a corresponding exemption from local property taxes with one significant difference: there is no three-mile criteria. A check with the appropriate county assessor may show they had already granted or denied the exemption.

Audits of Dealers: Auditors need to verify that dealers making this type of exempt sale obtain and retain a completed Watercraft Exemption Certificate (See Regulation 1594).

AIRCRAFT DEALERS**0635.00****GENERAL****0635.05**

1. Aircraft Dealers

The only state agency which issues a permit or license to an aircraft dealer to sell aircraft is the California Department of Tax and Fee Administration (CDTFA). A Taxable Activity Registration record is created on the CDTFA's registration system using a business code '67' or a notation of an occasional sale of aircraft in the regular course of business on the Taxpayer Information screen of the registration record. When the seller or buyer of an aircraft is an approved aircraft dealer, CUTS assumes sales tax reimbursement was collected or the purchase was for resale. The source document and a copy of the bill of sale, when available, is sent to the district audit section for their action, and no further action is taken by CUTS.

2. Seller With or Without Permit

When the seller does not hold a seller's permit, or the seller holds a permit and does not sell aircraft in the regular course of business, the purchaser is assigned a Consumer Use Tax Section account number. The tax program "SP" prefixes all account numbers. In most cases, the source document shows the buyer and seller as private parties or no former owner is shown. However, the buyer may have actually purchased the aircraft from an aircraft dealer. If the purchaser submits a purchase invoice showing the amount of sales tax reimbursement paid and the statement is verified, then the file is closed and the copy of the purchase invoice is forwarded to the dealer's field office of control. When the statement shows a purchase from a seller who holds a permit but is not an aircraft dealer, or when the statement claims sales tax is paid to a person who does not hold a seller's permit, the purchaser remains liable for payment of the use tax until the account is settled.

3. Dealers Who Act as Brokers

Section 6202 of the Revenue and Taxation Code provides that a person's liability for use tax is relieved when that person purchases an aircraft through a broker if the purchaser has paid an amount specified as sales or use tax to the broker and obtains a receipt showing the payment of the tax. In this case, the broker is liable for that amount under Law Section 6204 as if the broker were a retailer engaged in business in this state, and the amount collected constitutes a debt owed by the broker to this state. The purchaser is relieved of the use tax only up to the amount collected by the broker.

DEFINITION**0635.10**

An aircraft is defined as any contrivance designed for powered navigation in the air except a rocket or missile (Regulation 1593).

SOURCE DATA**0635.15**

Each month, the Consumer Use Tax Section downloads the master file registration from the Federal Aviation Administration's Internet Website. This file is matched against the prior month and all changes to aircraft registered to a California address are captured. The Technology Services Division processes this information and adds it to CUTS source information file. Each change that occurred to an aircraft registered with a California address or transferred from an out-of-state address to a California address during the previous month will be further investigated. This information is also supplied to the appropriate County Assessor for property tax purposes.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

APPLICATION OF TAX ON SALE AND PURCHASE OF AIRCRAFT

0635.20

Every sale or purchase of an aircraft is subject to either the sales tax or the use tax, unless it is specifically exempt. Every sale of an aircraft is a sale at retail, and by definition, the seller is a retailer. An aircraft is mobile transportation equipment for leasing purposes.

Pursuant to Regulation 1593, tax does not apply to the sale of and storage, use or other consumption of aircraft sold, leased, or sold to persons for the purpose of leasing, to:

1. a person who operates the aircraft as a common carrier of persons or property, provided:
 - the person operates the aircraft under authority of the laws of this state, of the United States, or any foreign government, and
 - the person's use of the aircraft as a common carrier is authorized or permitted by the person's governmental authority to operate the aircraft;
2. a foreign government for the use of the aircraft by the government outside of California, or,
3. a nonresident of California who will not use the aircraft in this state other than to remove the aircraft from California.

Aircraft dealers making exempt sales of aircraft must obtain an Aircraft or Aircraft Parts Exemption Certificate (See Regulation 1593).

For sales to common carriers see law section 6366(b) and for leases of common carriers see law section 6366(c) for \$50,000 or 20% presumption. Law section 6366.1(c) regarding leases to common carriers with a \$25,000 or 10% presumption is superseded by section 6366(c).

AUDIT PROCEDURES

0635.25

During an audit of a California aircraft dealer or dealer/broker, the auditor shall schedule leads on certain apparently valid and properly supported exempt sales of aircraft as follows:

1. All exempt sales to nonresidents other than bona fide dealers.
2. Any exempt sales to common carriers or foreign governments which seem to be valid but which might have some questionable aspects.
3. All brokerage transactions.

The Form CDTFA-379-A, Aircraft Exempt Sale Referral has been developed for this purpose. The auditor shall perform sufficient verification to ensure that no transactions are listed which are properly the liability of the taxpayer under audit; i.e., list only transactions which audit verification indicates are the responsibility of the purchaser rather than the dealer.

It should be determined that the dealer has not in effect encouraged false documentation. If it can be established that the dealer knew the facts stated in the documentation were not true, the tax plus applicable interest and penalties should be assessed against the dealer. A dual determination against the purchaser might be justified in some situations.

All such listings of transactions should provide as much information as possible but should include as a minimum: The name and address of the purchaser and seller; the type of aircraft including make, model, serial number and tail number; the state in which the aircraft is registered; the selling price; the basis on which the transaction was claimed as exempt, e.g., nonresident, common carrier, foreign government or brokerage; and the place of delivery. A separate Form CDTFA-379-A should be prepared for each transaction. A photocopy of the exemption certificate and invoice, if available, should be attached to the CDTFA-379-A.

AUDIT PROCEDURES

(CONT.) 0635.25

Transactions should also be listed during audits of other accounts involving exempt sales of aircraft where the purchaser would be responsible for tax such as:

1. Sales of aircraft by other in-state sellers (nondealers) to residents and nonresidents.
2. Sales of aircraft by out-of-state sellers (dealers and nondealers) to California residents and sales to nonresidents that may have some indications that the aircraft was purchased for use in California.

The Form CDTFA-379-A on such apparently exempt sales transactions should be forwarded directly to CUTS. CUTS will correlate this data with their own sources of information and prepare determinations where appropriate. Time expended in preparing leads on purchasers should be charged to Time Code 3108.

CO-OWNERS

0635.30

One peculiarity often encountered in aircraft ownership (which occurs less frequently in the ownership of vehicles or vessels) is that several persons often own a single aircraft.

In this event, the printout will list the buyer's name followed by "co-owner." Since the purchase of part ownership in an aircraft is taxable (the measure of tax being that amount paid for the partial interest), a letter will be prepared by CUTS notifying the buyer of the possible tax liability and also to obtain the name or names of the additional owners. Each additional owner will be notified of the possible tax liability.

When an aircraft has multiple owners, a determination will be issued for the full liability to each owner. However, if there is information as to the exact percentage owned by each partner, the determination will be issued to each partner for his or her prorated amount. Each person will have a separate account number.

When a co-tenancy is dissolved and a surviving owner makes a payment to a departing owner, including a payment made prior to the transfer for the benefit of a tenant not matched by such tenant, all contributions would be considered as taxable measure; i.e., the monthly loan payments made by only one of the tenants.

USE IN CALIFORNIA

0635.35

For purposes of the storage and use exclusion provided in section 6009.1 of the Revenue and Taxation Code, no taxable "use" of property occurs in this state where the sole exercise of power or control over the property in this state consists of the transporting of the property under its own power to the out-of-state point for use thereafter solely outside California. An aircraft is used solely outside California if it does not return to California within six months after its exit and it is substantially used in revenue and company service during this six-month period. **This relates only to use tax.**

Whether or not the purchaser has made another use of the property while in California or while transporting the aircraft outside the state, such as transporting luggage or business property, is a factual matter which must be decided on a case-by-case basis.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

USE IN CALIFORNIA

(CONT.) 0635.35

Examples of Specific Applications:

1. Airplane parts brought to California and attached to planes which are being modified in California are exempt from use tax where the finished planes are flown directly out of the state for use thereafter outside the state. However, if any other use is made of the plane, such as transportation of persons or property on its flight outside the state, tax does apply.
2. An airplane which is part of a dealer/lessor's ex-tax inventory in this state is flown by the dealer/lessor to a point outside this state for delivery to the lessee for use thereafter solely outside the state. The lease commences at the out-of-state point. The transaction is exempt from use tax under section 6009.1.
3. Airplane parts purchased from a California retailer and delivered to the purchaser or his/her agent in this state for attachment to planes being modified which are later flown directly out of the state for use thereafter outside the state are subject to tax. Law section 6009.1 is not applicable since this is a sales tax transaction.
4. A lessor purchased an airplane for resale and leased the plane to an out-of-state lessee. The terms of the lease explicitly provide that the lease was to commence in California even though the property was to be delivered by the lessor to the lessee out-of-state at some later date. The storage and use exclusion provided in law section 6009.1 is not applicable since the lease commenced in this state. When mobile transportation equipment purchased for resale is leased, with the lease commencing in California, and with the use in California being limited to leasing, law section 6094(d) and section 6244(d) specifically provide that use tax applies to fair rental value "whether the equipment is within or without the state," provided a timely election is made.

VEHICLE INDUSTRY — TERMINOLOGY — REGULATIONS**0640.00****TERMINOLOGY****0640.05**

Certain terminology is used in the automobile industry. The terms defined below are the most common used. The list may be useful for the auditor to understand how the industry operates.

Accommodation Sales:

These are usually sales of personal cars of management personnel, sales persons or employees. It is immaterial that the car was displayed at the dealer's place of business. The dealer will be liable for sales tax if the dealer prepared a dealer's Report of Sale or the dealer executes a conditional sales contract on which the dealer's name appears as the seller.

Actual Cash Value (ACV):

The wholesale value assigned to a trade-in or purchase. The ACV will usually differ from trade-in allowance. ACV is determined by the dealer at the time of purchase or trade, based on valuation guides and adjusted for the specifics of each vehicle. ACV can be higher or lower than the trade-in allowance.

Auto Auction:

Auto auctions are generally of two types. Dealer auctions are open to licensed car dealers only. Public auctions are open to every one. Selling prices are set through competitive bidding on each vehicle rather than by the seller.

Book Value:

The wholesale value of a given used vehicle as determined by a recognized wholesale appraisal guidebook.

Autobroker:

A middleman who locates cars for other dealers, usually on a commission basis. An autobroker does not take title or possession of the cars, whereas a wholesaler takes possession and title of the cars.

Buy Here / Pay Here:

A dealer that offers in-house financing for the cars sold.

Car Jacket (Deal Jacket):

The complete history of a vehicle from the time it is purchased to its sale. The jacket usually contains the purchase and sales documents, any invoices associated with repairs, delivery and parts, an odometer statement, and vehicle identification number, stock number and other records pertaining to the sale. The jacket is normally a folder containing all the information.

Charge Back:

A loan financed through the dealer is paid off sooner than the loan term. The finance company will make the dealer pay back part of the commission. This also happens with insurance commissions.

Consignment:

An arrangement under which a dealer agrees to accept possession of a vehicle from the owner for the purpose of selling the vehicle and pay the owner from the proceeds of the sale. It does not include the wholesale transaction at a licensed auto auction.

Courtesy Deliveries:

- **Factory Directed** — This is a transaction in which an out-of-state dealer sells a vehicle to a customer but directs the manufacturer to make delivery to the customer at a specified location in California.
- **Not Factory Directed** — This involves a delivery from the dealer's inventory to a customer of an out-of-state dealer based on direct correspondence between the respective dealers, and without participation by the manufacturer.

Curbing:

Sale of a vehicle by an unlicensed dealer from a shopping center parking lot or similar area.

Customer File:

See Car Jacket.

Deal:

The completed sale of a car or truck to an individual or another dealer.

Dealer Financing:

A dealer financing his or her own sales by servicing the note in-house or by selling the note to a third party at a discounted amount.

Dealsheet:

The sales order or invoice showing the sale of a vehicle to an individual or another dealer.

Demand Title

When a purchaser demands title for a vehicle which has been purchased free of any liens or encumbrances, the dealer is required to complete a used vehicle Report of Sale in the usual manner.

Demos:

Normally, these are vehicles which are used by dealership personnel for personal use along with demonstration or display in the regular course of business.

Detailing:

To prepare a car for resale. This usually includes cleaning, minor repairs and cosmetic work.

Discount:

The difference between the asking or list price and the final sales price of a vehicle.

Dismantler:

One who is engaged in the business of buying or selling, or otherwise dealing in vehicles for the purpose of dismantling, who buys or sells the parts and materials thereof, or deals in used motor vehicle parts.

Doc Fee:

A fee charged for processing or handling the documentation of a sales transaction.

Domebook:

A journal used by small businesses to help organize income and expenses on a monthly basis.

Double Dip:

Person with a loan for the purchase of a car and with additional outside financing for down payment that may not be shown as a lien on the title.

TERMINOLOGY**Factory Dealer-Incentive:**

The manufacturer sells the vehicle to the dealer at a discounted price to promote the sale of the vehicle.

Factory Invoice:

A receipt from the manufacturer identifying the cost of the vehicle, dealer's name and address and listing of the vehicle's identification number and make.

Flooring:

Costs incurred in obtaining inventory, usually through loans from banks or other financial institutions. Includes interest on the loans.

Grey Market Cars:

Cars imported through sources other than factory authorized distributors.

Grossing Up The Deal:

Recording an underallowance as a credit to cost of new vehicle.

Guidebook:

A book used to value trade-ins and cars in inventory. It is also used for sale purposes. The most common guidebook used in the industry is the Kelley Blue Book.

In-House Financing:

Financing provided by the dealer.

Internal Sales:

This is a means for the selling department to apportion its cost of doing business to another department within the dealership.

Legal Owner / Lienholder:

A person holding a security interest in a vehicle.

Lemon Law:

Civil Code sections 1793.2, 1793.22, 1793.23, 1793.24, 1793.25 and 1794 are commonly known as the Lemon Law. The Lemon Law provides an arbitration process for resolving disputes between manufactures and consumers of new motor vehicles purported to have major manufacturing defects. If the mediator rules in favor of the consumer, the manufacturer is required by law either to replace the motor vehicle or reimburse the consumer for the purchase price.

License Fees:

The Vehicle License Fee Law imposes a license fee for the privilege of operating in this state any vehicle of a type subject to registration under the Vehicle Code.

List Price:

The original suggested retail price (including destination charges).

Manufacturer's Rebate:

A manufacturer's rebate is an allowance made by the manufacturer directly to a consumer as an incentive to purchase the manufacturer's vehicle from a dealer.

TERMINOLOGY**Manufacturer Suggested Retail Price (MSRP):**

See List Price.

Motor Vehicle Security Agreement:

Basic document of sale.

Overallowance:

An allowance given on a trade-in in excess of its actual cash value. This is used as a means to close the deal. Usually, the difference is made up by decreasing the discount on the car sold.

Package Deal:

The purchase of two or more vehicles for a lumpsum price. This generally occurs between dealers and is one way to sell a car that otherwise would be difficult to move.

Pink Slip:

Certificate of title for ownership of vehicle. From 1989, the new certificate of title is multicolored (green, yellow, and pink) and is 8" x 7".

Rate Spread:

This occurs when a dealership has made arrangements to write car loans for a financial institution. The dealership will pre-arrange the amount of interest rate that the financial institution will charge on car loans to buyers. The dealership will then write loans at a higher rate and receive the excess interest as income payment from the financial institution.

Reconditioning:

Any work done to prepare a vehicle for sale.

Repo:

Repossession of a vehicle when the purchaser defaults on the loan.

Report of Sale:

New — A new vehicle Report of Sale is used for reporting the sale of a new vehicle which the dealership is franchised to sell.

Used — A used vehicle Report of Sale is used for reporting the retail sale of a used vehicle.

Wholesale — A wholesale Report of Sale is used to report sales of used vehicles from dealer to dealer.

Roll back:

A vehicle purchased and operated on a Report of Sale and returned to the dealer for some reason (credit unavailable, customer changed mind, etc.) prior to completion of the transaction and issuance of the title.

Skip:

Reneg on payment of a loan. The term also applies to a buyer who cannot be located.

Stock Book:

This journal typically lists each vehicle delivered to the dealership in chronological order. Depending on the person maintaining this book, it could be a more complete listing of customer name, date vehicle received and sold, VIN#, etc.

TERMINOLOGY**Sublet:**

Work performed by outside vendors, usually when the dealer is not equipped for the work, or is unable to perform the work within a reasonable time.

Trade-Down:

A retail customer trades a car for one of lesser value.

Trade-in:

An item taken in by a dealer as part of a deal on the sale of a vehicle from dealer's inventory. Trade-ins are usually vehicles, but may be a boat, motorcycle, camping trailer or other items agreed on by the dealer and customer.

Underallowance:

Recorded trade-in allowance that is below market value and which is not attributed to less than fair condition of the trade-in.

Up Front Costs:

Also known as "drive away" charges, includes capitalized cost reductions (additional charges to use and possess the property), document preparation charges, bank fees, assumption fees, deferral fees, and excessive wear and use charges (e.g., excessive mileage fees). Generally, dealers collect these "up front" charges from a lessee at inception of a lease (including the first months rental charge).

Unwind:

The same as a canceled sale. When a vehicle is documented but the customer does not take possession and cancels the sale. This amounts to reversing the sale.

Used Car Log:

A record of all purchases and sales of used cars, usually showing the year, make, identification number, date purchased, date sold, the source of dealer's purchase and the dealer's customer.

Vehicle Identification Number:

The unique identification number assigned to a vehicle by the manufacturer.

Warranty:

Protection plan or guarantee on the car and/or certain systems such as the drive train.

Wholesaler:

Specializes in selling vehicles to other dealers for an agreed price. Unlike an autobroker, the wholesaler takes possession and title of the vehicle. They do not sell to the general public.

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

SALES TAX REGULATIONS PERTAINING TO AUTOMOBILE DEALERS 0640.10

- 1546 — Installing, Repairing, and Reconditioning in General
- 1548 — Retreading and Recapping Tires
- 1551 — Repainting and Refinishing
- 1553 — Miscellaneous Repair Operations
- 1566 — Automobile Dealers and Salesmen
- 1566.1 — Auto Auctions and Auto Dismantlers |
- 1569 — Consignees and Lienors of Tangible Personal Property for Sale
- 1610 — Vehicles, Vessels, and Aircraft
- 1619 — Foreign Missions and Consuls |
- 1620 — Interstate and Foreign Commerce
- 1621 — Sales to Common Carriers
- 1628 — Transportation Charges
- 1641 — Credit Sales and Repossessions
- 1642 — Bad Debts
- 1654 — Barter, Exchange, “Trade-ins” and Foreign Currency Transaction
- 1655 — Returns, Defects and Replacements
- 1660 — Leases of Tangible Personal Property — In General
- 1661 — Leases of Mobile Transportation Equipment
- 1668 — Resale Certificates
- 1669 — Demonstration, Display and Use of Property Held for Resale — General
- 1669.5 — Demonstration, Display, and Use of Property Held for Resale — Vehicles
- 1684 — Collection of Use Tax by Retailers
- 1685 — Payment of Tax by Purchasers
- 1700 — Reimbursement for Sales Tax

Table of Exhibits

Consumer Use Tax Section — DMV Information	Exhibit 1
Information Sources - Audit	Exhibit 2

VEHICLE, VESSEL, AND AIRCRAFT DEALERS

CONSUMER USE TAX SECTION — DMV INFORMATION

EXHIBIT 1

DMV information available in an R67 inquiry:

Basic Record	All available information on a vehicle/vessel (basic record and all subrecords) and can be accessed by inquiring via the vehicle identification number/vessel hull identification number (VIN), vehicle/vessel license number or registered owner name.
Sub:B	Vehicle/vessel description and additional registered owner information. In addition, may also indicate whether use tax and/or parking violation fees were paid.
Sub:C	Second group of vehicle/vessel description and registered owner information.
Sub:D	Legal owner information.
Sub:E	Record Condition Code and additional data (if available).
Sub:F	Plate with owner trailing records.
Sub:G	Parking violation information.
Sub:H	Receipt date of prior Notice of Release of Liability. (no longer updated)
Sub:J	Notice of Release of Liability information.
Sub:K	Situs information.
Sub:M	Manual and automated clearance data, vehicle registration refund information, and cleared parking citation data.
Sub:R	Prior registered owner/prior legal owner history (maximum of 8 records and/or three years prior).
Sub:S	Micrographics index information.

In addition, the following information may also be available upon review of the microfilm:

- | | |
|-------------------------------------|---|
| 1. Registration receipt | 4. Statement of Fact |
| 2. Certificate of Title (pink slip) | 5. Power of Attorney |
| 3. Bill of Sale | 6. Other documents provided to the DMV upon registration. |

Status Codes

Code	Code Title	Description
1	Paid Use Tax	Review of registration record and microfilm indicates use tax was paid by purchaser name provided; amount of use tax paid will be shown.
2	No Use Tax Paid	Review of registration record and microfilm indicate no use tax paid by purchaser name provided.
3	No Record of VIN or License Number	Vehicle identification or license number provided is either incomplete or not valid.
4	Registered Owner Not Listed	Purchaser name provided is not listed as the registered owner on the R67 record.
5	Dealer Transaction	Registration record indicates dealer to dealer transaction.
6	Information Provided Does Not Match VIN or License Number	Vehicle identification or license number does not match vehicle make and year provided.
7	Lost Record	Unable to locate microfilmed documents on tape.
8	No Record on Film	Registration packet not on microfilm.
9	Vehicle/Purchaser Name Mismatch	Vehicle year/make provided not listed as registered to purchaser name provided.
10	No Vehicle to Name Match	No vehicles registered to purchaser name provided.
11	Purchaser Name Common	Numerous matches for criteria provided.
12	Microfilm Tape Not Available	Information too new and not on tape yet or microfilm too old.

- DMV's Occupational License Status Information System: – Provides information on type of dealer license held and owner information, and allows for searches by name, city, or dealer license number.
- Internet Search Engines: www.google.com and www.yahoo.com - Used to search for articles or other information pertaining to a specific dealer.
- Car Dealer's Website – Information may include details regarding inventory, types of vehicles for sale, business contact names, business history.
- Used Car Dealer News: – General used car industry news, including profiles of specific vehicle dealers.
- Automotive Digest: Online magazine that provides automotive industry news, developments, and activities in the automotive industry published by major national and global print publications, magazines, wire services, Internet newsletters, and newspapers.
- The Autochannel: www.theautochannel.com – New and used vehicle information, link to classified ads section used by some used car dealers to advertise vehicles for sale.
- CA Motor Car Dealers Association: www.cncda.org – Association of franchised car dealers. Website provides industry data and publications, including “California Auto Outlook” bulletin, Economic Impact Reports, and news releases.
- NorCalCars: Small online auto mall, provides inventory information for some smaller independent used car dealers located in Northern California.
- Trade Express: - Provides inventory information for some used and new car dealers located in Southern California.
- Auto Trader: www.autotrader.com – Online classified ads, including ads placed by used car dealers.
- Bizstats: Small business statistics, including industry specific information such as inventory turnover rate, profit margin, etc.
- DMV Financial Institutions List: is an alphabetized listing of banks, credit unions and financial/lending institutions that provide vehicle loans in California.
- National Independent Auto Dealers Association (NIADA): www.niada.com – Trade website with information and links to auto auctions, trade publications, and other industry related news and information.
- Independent Automobile Dealers Association of California: www.iadac.org – California dealers' trade website with information and links to auto auctions, trade publications, and other industry and related news and information.