Memorandum

To: REDACTED TEXT

Date: October 27, 1993

From: Sukhwinder K. Dhanda

Subject: **REPEAL OF THE FEDERAL LUXURY TAX**

This is in response to your request for research on the repeal of the federal luxury tax and whether that repeal may require any refunds from the state.

Background

Between January 1, 1991 and December 31, 1992, a federal luxury excise tax was imposed on retail sales of vehicles priced above $30,000, boats and yachts priced above $250,000, aircraft priced above $100,000, jewelry priced above $10,000 and fur articles priced above $10,000. Effective for retail sales occurring after December 31, 1992, the 1993 Revenue Reconciliation Act (Public Law 103-66, 8/10/93) repealed the luxury tax for all items except passenger vehicles priced above $30,000.[1] The only luxury tax in effect currently is the 10% luxury tax which applies to the first retail sale of a newly manufactured passenger vehicle. It also applies, with some exceptions, to the use of a taxable vehicle before its first retail sale, and certain leases of passenger vehicles.

The repeal of the luxury tax for all items except passenger vehicles was retroactive to December 31, 1992. Taxpayers who purchased the other luxury items listed above after 1992 are entitled to refunds. Because the retailers and not the customers generally remitted the tax, the retailers must file the refund claim with the IRS. Customers who paid the tax directly (for example on luxury items that were imported for personal use), may file a direct refund claim. Customers who paid the tax as part of the purchase price should contact the retailers for their reimbursements. (IR 93-66 IRS News Release.) Retailers who file for refunds must certify that either they have refunded the tax to the customers, that they have signed consent from the consumer allowing the credit or refund or that they did not include the tax in the selling price nor collect it from the consumer. Any luxury taxes collected from customers but not deposited with the IRS must be refunded to the customers who paid the tax. Specific detailed information on how to file claims for refunds as a result of the repeal of the luxury tax can be found in the Current Rulings of the Internal Revenue Service ¶ 101, 196 -101,198 and in Internal Revenue Bulletin 1993-29 (Notice 93-44).

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[1] The Act also repealed the luxury tax on any part or accessory installed on a passenger vehicle after 12/31/90 if the part or accessory was installed to enable or assist an individual with a disability to operate or to enter and exit the vehicle.

Relation to California Sales Tax

As you know, Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. "Gross receipts" is defined in Revenue and Taxation Code section 6012. Subdivision (c) (4) (A) of section 6012 states that "gross receipts" does not include the amount of any tax (not including any manufacturer's or importer's excise tax) imposed by the United States upon or with respect to retail sales whether imposed upon the retailer or the consumer.

The Board's position on the treatment of the luxury tax is found in Annotation 295.1252 (12/6/90) which states:

> "**Luxury Tax**. Effective January 1, 1991, the United States has imposed a new retail excise tax, on the first retail sale of vehicles, boats, aircraft, jewelry and furs, to the extent that the price for such goods exceeds certain specified amounts. The rate of tax is 10 percent. The new tax is excludable from 'gross receipts', under Revenue and Taxation Code section 6012(c) (4) (A). The amount of any such tax is nontaxable under the Sales and Use Tax Law, whether imposed with respect to a sale involving a transfer of title or a lease transaction which is treated as a 'sale' and 'purchase' under Revenue and Taxation Code sections 6006 and 6010."

Therefore, when retail sales of vehicles, boats, aircraft, jewelry and furs were made in California, the measure of sales tax did not include the luxury tax. For purposes of the Sales and Use Tax Law, the sale of these items was taxed as other retail sales of similar tangible personal property. Thus, a refund of the luxury tax for these items does not give rise to any sales or use tax refund.

Leases

The luxury tax did raise some questions with respect to the application of that tax to leases, particularly where the lessor sought reimbursement for the luxury tax from the lessee.

The luxury tax applies to the "first retail sale", which is defined as the first sale, for a purpose other than resale, after manufacture, production, or importation. (I.R.C. § 4002(a).)

Under the Internal Revenue Code, a lease of an article by any person is considered a sale of that article at retail and tax applies to that lease. However, the sale of a passenger vehicle, boat or aircraft to a person engaged in a leasing or rental trad or business for leasing by that person in a “qualified lease” is not treated as the first retail sale and is not taxed. A “qualified lease” is any lease of a boat or aircraft, or a long term lease of a passenger vehicle (long term is defined as a lease with a term of one year or more.) In the case of a qualified lease which is treated as the first retail sale, tax may apply in three ways:

1) The luxury tax is computed on the lowest price for which the article is sold by retailers in the ordinary course of trade.

2) The first lease is the retail sale and the luxury tax is imposed on each lease payment. The amount of tax on each lease payment is determined by looking to the amount of the total tax due and the number of payments under the lease. (For example, if there are 60 payments due under the lease, each lease payment will include 1/60 of the total luxury tax due.)

3) No tax is due on a qualified lease if the lessee's use of the article would have made the first retail sale of the article not taxable by the luxury item excise tax by reason of such use. (I.R.C. § 4002 (c) (sales or leases of passenger vehicles for the exclusive use in the business of transporting persons or property for compensation or hire (taxicabs) are and were previously excluded).)

Sales and Use" Tax Annotations also set forth the tax implications for such lease transactions. For a "Qualifying Lease", the relevant Annotation is 295.1257 (6/22/92), which states:

> "**Luxury Tax-Qualifying Lease**. Revenue and Taxation Code Section 6012 excludes taxes imposed by the United States upon or with respect to retail sales. The federal luxury tax is a tax on retail sales which includes leases. When a lessor of a qualifying lease elects to pay the luxury tax up front, he or she is paying a federal excise tax on the lease which is a retail sale. Qualifying lease "is a lease with a term of one year or more. Thus, the luxury tax on the lease is a tax imposed by the United States upon or with respect to retail sale, and is excluded from gross receipts. Assuming that the lease is a continuing sale and purchase, the amount excluded is a portion of each rental payment which, if the rental payments are equal, is calculated by dividing the total amount of the luxury tax by the number of rental payments due under the initial term of the lease.
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> "Where the luxury tax is imposed on rental payments, the amount of the luxury tax on each rental payment is excludable from the measure of tax whether the luxury tax is separately stated or included in the rental payments set forth in the lease. Also, if the lessor elects to pay the luxury tax up front and the lessee reimburses the lessor for the tax at the beginning of the lease, the reimbursement is not included in the measure of tax."

As stated above, it has been the Board's position that in either scenario involving qualifying leases, whether the luxury tax is imposed up front or on each lease payments, the amount of that tax is not included in "gross receipts" for purposes of the California Sales or Use Tax Law. Thus, a refund of the luxury tax involving sales of vehicles used in qualifying leases will not require a refund of any sales or use tax.

"Non-qualifying leases" are leases for a short term, such as daily rentals or leases for less than a year. Annotation 295.1255 (6/22/92) relating to "Nonqualifying Leases" states:

> "**Luxury Tax-Nonqualifying Lease**. Where the lessor leases the vehicle under a nonqualifying lease, the first retail sale is the sale of the vehicle to the lessor and the federal luxury tax is imposed on that sale, not on the lease. A nonqualifying

> lease is a lease with a term of less than one year, such as daily or other short term rental. Where the luxury tax is not imposed upon the transaction subject to sales or use tax, the luxury tax cannot be passed through to that subsequent taxable transaction and excluded from the gross receipts of that transaction. Thus, no amount of the rentals on daily or short term rentals is excludable from the measure of tax."

In these "nonqualifying leases", the sale to the lessor is the first retail sale and the lessor is required to pay luxury tax on that sale. For purposes of the California sales tax, the amount of that luxury tax is excluded from the "gross receipts" of that sale to the lessor. Thus, if the lessor elected to pay sales or use tax on its purchase price, the measure of that tax would not include the amount of the luxury tax. If instead, the lease is a continuing sale, the lessor may not exclude any amount related to the luxury tax from the rentals payable subject to use tax. While the amount of the luxury tax may presumably be passed through to the lessee, it is treated for tax purposes as any other overhead expense passed on to a lessee. When the lessor subsequently leases the vehicle (under a nonqualifying lease), the lease price may include an amount for reimbursement of the luxury tax that the lessor has paid. However, the luxury tax reimbursement in such a lease, even if separately stated, is still included in the measure of "gross receipts" for state sales and use tax purposes. The reasoning behind this conclusion is that the luxury tax is not being imposed upon the nonqualifying lease which is subject to sales or use tax. Thus, an amount passed through to the lessee of that nonqualifying lease (a taxable transaction) cannot be excluded from the gross receipts of that transaction.

Because of the structure of these “nonqualifying lease” transactions, a price adjustment (or a reduction in the gross receipts of the lessor) may be indicated. Regulation 1617 (e) states:

> “When a manufacturer receives a refund of federal manufacturers’ excise tax and repays the amount of the tax to the consumer directly or through the retailer pursuant to requirements of federal law, the repayment to the consumer will be regarded for sale and use tax purposes as a price adjustment. Taxable gross receipts of the retailer for the period in which the repayment is made to the consumer will be reduced accordingly, and sales tax previously paid by the retailer on the amount will be refunded to the retailer, provided he also repays the consumer the amount collected from him as sales tax reimbursement.”

For example, if the lessor’s purchase of an aircraft was regarded as the first retail sale (thus, the lessor paid luxury tax up front) and he then leased it under a nonqualifying lease, any luxury tax reimbursement in that lease amount was simply an overhead expense passed on to the lessee and subject to California use tax. In order to file a claim for refund with he IRS, the lessor must either return the amount of the luxury tax he collected from the lessee or certify that the luxury tax was not included in the selling price nor did he collect it from the consumer (lessee). If the lessor does return the amount of the luxury tax collected to the lessee , the amount returned to the customer is regarded as a “price adjustment.” The lessor’s gross receipts for the period in which he made the repayment will be reduced accordingly provided the lessor also repays to the consumer the amount collected as use tax. Thus, in these limited circumstances, a refund of the

use tax paid (measured by the amount of the luxury tax included in “rentals payable”) will be required.

Refunds

As stated earlier, because of the retroactive application of the luxury tax repeal, taxpayers are entitled to refunds from the IRS for purchases of items subject to the tax made after December 31,1992. However, this retroactive application does not indicate any refunds from the state are due since the amount of the luxury tax was not included in "gross receipts" used to determine the measure of sales or use tax. The only sales or use tax implication would be with respect to a lease of a passenger vehicle in a nonqualifying lease where the lessor repays the amount collected for luxury tax to the lessee.

SKD:plh

Memorandum

To: Mr. Gary J. Jugum Date: October 21, 1993

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The repeal of the luxury tax for all items except passenger vehicles was retroactive to December 31, 1992. Taxpayers who purchased the other luxury items listed above after 1992 are entitled to refunds. Because the retailers and not the customers generally remitted the tax, the retailers must file the refund claim with the IRS. Customers who paid the tax directly (for example on luxury items that were imported for personal use), may file a direct refund claim. Retailers who file for refunds must certify that they have refunded the tax to the customers and they must also certify that they did not include and collect the luxury tax in the selling price.

Relation to California Sales Tax

As you know, Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. "Gross receipts" is defined in Revenue and Taxation Code section 6012. Subdivision (c) (4) (A) of section 6012 states that "gross receipts" does not include the amount of any tax (not including any manufacturer's or importer's excise tax) imposed by the United States upon or with respect to retail sales whether imposed upon the retailer or the consumer.

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> furs, to the extent that the price for such goods exceeds certain specified amounts. The rate of tax is 10 percent. The new tax is excludable from 'gross receipts', under Revenue and Taxation Code section 6012(c) (4) (A). The amount of any such tax is nontaxable under the Sales and Use Tax Law, whether imposed with respect to a sale involving a transfer of title or a lease transaction which is treated as a 'sale' and 'purchase' under Revenue and Taxation Code sections 6006 and 6010."

Therefore, when retail sales of vehicles, boats, aircraft, jewelry and furs were made in California, the measure of sales tax did not include the luxury tax. For purposes of the Sales and Use Tax Law, the sale of these items was taxed as other retail sales of similar tangible personal property. Thus, a refund of the luxury tax for these items does not give rise to any sales or use tax refund.

Leases

The luxury tax did raise some questions with respect to the application of that tax to leases, particularly where the lessor sought reimbursement for the luxury tax from the lessee.

The luxury tax applies to the "first retail sale", which is defined as the first sale, for a purpose other than resale, after manufacture, production, or importation. (I.R.C. § 4002(a).)

Under the Internal Revenue Code, leases of passenger vehicles may be treated as the first retail sales of the vehicle and subject to the luxury tax. (I.R.C. § 4002(c) (sales or leases of passenger vehicles for the exclusive use in the business of transporting persons or property for compensation or hire (taxicabs) are excluded).) Leases for a term of one year or more are labelled "qualifying leases" whereas daily or short term leases are "nonqualifying leases."

If a lease of a vehicle is treated as the first retail sale, then the luxury tax is imposed on the lease of the vehicle and is paid by the lessor.

If a lease is not treated as the first retail sale, and unless an election is made to pay the total luxury tax up front, the luxury tax is imposed on each lease payment. The amount of tax on each lease payment is determined by looking to the amount of the total tax due and the number of payments under the lease. (For example, if there are 60 payments due under the lease, each lease payment will include 1/60 of the total luxury tax due.)

Sales and Use" Tax Annotations also set forth the tax implications for such lease transactions. For a "Qualifying Lease", the relevant Annotation is 295.1257 (6/22/92), which states:

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> with a term of one year or more. Thus, the luxury tax on the lease is a tax imposed by the United States upon or with respect to retail sale, and is excluded from gross receipts. Assuming that the lease is a continuing sale and purchase, the amount excluded is a portion of each rental payment which, if the rental payments are equal, is calculated by dividing the total amount of the luxury tax by the number of rental payments due under the initial term of the lease.
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As stated above, it has been the Board's position that in either scenario involving qualifying leases, whether the luxury tax is imposed up front or on each lease payments, the amount of that tax is not included in "gross receipts" for purposes of the California Sales or Use Tax Law. Thus, a refund of the luxury tax involving sales of vehicles used in qualifying leases will not require a refund of any sales or use tax.

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through to the lessee of that nonqualifying lease (a taxable transaction) cannot be excluded from the gross receipts of that transaction.

Therefore, nonqualifying lease transactions would not give rise to any type of a refund of California sales or use tax since the transaction taxed by the state was not subject to the luxury tax. Thus, a refund of the luxury tax involving sales of vehicles used in nonqualifying leases will not require any refund of the state sales tax.

Refunds

As stated earlier, because of the retroactive application of the luxury tax repeal, taxpayers are entitled to refunds from the IRS for purchases of items subject to the tax made after December 31,1992. However, this retroactive application does not indicate any refunds from the state are due since the amount of the luxury tax was not included in "gross receipts" used to determine the measure of sales or use tax.

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