M e m o r a n d u m

490.0511

To: Aaron Phillips
Audit Review & Refund Section
MIC:39

Date: May 17, 1994

From: Rachel M. Aragon
Staff Counsel

Subject: X----------
Lemon Law Claims & Refunds

This is in response to you memorandum dated March 1, 1994 in which you ask whether the Lemon Law applies to vehicles purchased for purposes other than personal, family, or household use.

You state that a claim for refund under the Lemon Law was denied to X---------- or a vehicle it replaced for X---------- of X----------. you enclosed copies of correspondence between the Board, X---------- (attorneys for X----------), a General Release between X---------- and a letter from X---------- to X----------. In your letter to X---------- dated March 1, 1994, you state, in part:

> "Civil Code 1793.2 (e) (4) (B) explains that 'new motor vehicle' means a new motor vehicle which is used or bought primarily for personal, family, or household purposes.
>
> "Upon examination of the documents provided with regard to your claim for refund, it was determined that this vehicle does not meet the above noted definition. Therefore, we are unable to grant your request for refund."

In addition to responding to your specific question, we will provide you with some general rules with regard to replacements pursuant to settlement agreements as they pertain to the Lemon Law.

Discussion

When a manufacturer is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer must either replace the new motor vehicle or make restitution to the buyer. The buyer may elect restitution in lieu of replacement and in no event is the buyer

required to accept a replacement vehicle. (Civ. Code § 1793.2(d) (2).) In order for a replacement to constitute a Lemon Law replacement, the motor vehicle must be transferred to the buyer by the manufacturer (as it was in this case), or on the manufacturer's behalf.

When there is a qualifying Lemon Law replacement, that replacement is treated the same as a mandatory warranty replacement. As with a mandatory warranty, the replacement vehicle is regarded as sold to the customer as part of the original sale of the vehicle. The sale of the replacement" vehicle to the manufacturer is a sale for resale and is not taxable. There is no refund of the tax paid with respect to the sale of the original vehicle to the customer, but there is also no additional tax due with respect to the replacement, provided the customer is not required to make any additional payments with respect to the replacement. (Reg. 1655 (c) (2) .) If the customer is required to make additional payments with respect to the replacement, as X---------- did, the additional payment amount is subject to sales tax (the difference between the original sales price and the price of the replacement vehicle). Thus, if the replacement vehicle is a Lemon Law replacement, there would be no refund of sales tax to the manufacturer; however, the only additional tax which would be due is the tax on the additional payment.

A replacement is not a Lemon Law replacement if the settlement terms state in any way that the settlement is a compromise of a disputed claim or that the settlement does not constitute an admission of liability or that the settlement is merely to avoid litigation. In other words, if the parties to a replacement agree that it is not a Lemon Law replacement, then it is not a Lemon Law replacement. This is true even under circumstances where the purchaser could have forced the manufacturer to make restitution or replacement under the Lemon Law. Furthermore, this is true even if the settlement is to settle litigation or to avoid litigation.

In reviewing the General Release between Favero and Ferrari which you included with your memorandum, we conclude the release does not comply with the Lemon Law requirements. This is based on the following wording found on page 3, section 4 of the Release:

> "Releasor further understands and agrees that the settlement reflected hereby constitutes a compromise of doubtful and disputed claims, and that payment being made thereby is not to be construed as an admission of liability on the part of Releasees or any of them, by whom liability is expressly denied."

As explained above, it is not a Lemon Law replacement if the settlement terms state in any way that the settlement is a compromise of a disputed claim or that payment does not constitute an admission of liability. Thus, this is not a Lemon Law replacement.

You have asked whether a vehicle purchased for business comes within the confines of Civil Code section 1793.2(d) (4) (B) which defines a new motor vehicle as a new vehicle which is used or bought for use primarily for personal, family or, household purposes. With regard to X----------, you have not supplied us with sufficient

information to determine if the vehicle was used or bought for use primarily for personal, family, or household purposes or whether it was purchased or used primarily for business purposes. Generally, primarily means more than 50 percent of the time.

In summary, this is not a replacement vehicle under the Lemon Law because the parties did not agree that this was a replacement vehicle under the Lemon Law. In addition, if the vehicle was used or purchased for use primarily for business purposes, it is not a Lemon Law replacement. Finally, even if it were a Lemon Law replacement the manufacturer would not be entitled to a sales tax refund because sales tax would have only been paid on the original sale (the second sale would have been classified as a sale for resale and not a new taxable sale) and any additional tax paid would have been on the amount paid by the customer for the replacement.

If you have any further questions please feel free to write again.

RMA/md
claimref