



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date:	03/29/12	Bill No:	Assembly Bill 1941
Tax Program:	Property Heavy Equipment	Author:	Ma
Sponsor:		Code Section:	RTC 5500, et seq.
Related Bills:		Effective Date:	01/01/13

BILL SUMMARY

This bill imposes a tax of 1.25% on the lease or rental of heavy equipment, as specified and defined, and requires the lessor of the equipment to collect the tax based on the gross receipts derived from that lease or rental. The bill specifies that the tax is in lieu of the property tax.

ANALYSIS

CURRENT LAW

Property Tax. Under existing law, all property is taxable unless there is a specific constitutional or statutory exemption. The determination of taxability is generally made as of the lien date, January 1 of each year. Under California's Property Tax Law (Part 1, Division 1 of the Revenue and Taxation Code, commencing with Section 50), personal property used in a trade or business is generally taxable, and its cost must be reported annually to the assessor on a business property statement, as provided by Revenue and Taxation Code Section 441. Personal property is valued each lien date at its current fair market value. Generally, determining the fair market value is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of reproduction cost new. The reproduction cost new is then multiplied by a percent good factor (from percent good tables issued by the Board of Equalization (BOE) to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the property for the fiscal year. Specific percent good tables are issued for Construction and Agricultural Mobile Equipment. The tax rate levied is the same as the rate on real property; that is 1% plus voter approved indebtedness, which varies by locality.

Article XIII, Section 2 of the California Constitution authorizes the Legislature to classify personal property for differential taxation or for exemption by means of a statute approved by a 2/3 vote of the membership of each house.

Although the Property Tax Law provides no specific exemption from the tax for the rental or lease of heavy equipment, there is a business inventory exemption available for personal property intended for rent or lease in the ordinary course of business that is not leased or rented on the January 1 lien date. In other words, if the property is not rented or leased on that particular day (returned to inventory), the property is exempt from taxation for the ensuing fiscal year. Specifically, Revenue and Taxation Code Section 219 exempts "business inventories" from property taxation and Section 129

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provides that "business inventories" includes goods intended for sale or lease in the "ordinary course of business" but excludes any goods actually leased or rented on the lien date. Further, Property Tax Rule 133 provides that the phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

Distribution of Revenues. Generally, property tax revenues from locally assessed property are allocated by the "situs" of the property and accrue only to those taxing jurisdictions in the tax rate area where the property is located. Pursuant to Property Tax Rule 204, property leased or rented on a daily, weekly or other short-term basis of six months or less has situs at the place where the lessor normally keeps the property. Temporary absences from that location do not change the situs of the property. The situs of property leased or rented for an extended, but unspecified, period or leased for a term of more than six months is determined on the basis of the lessee's use. With regard to leased equipment generally, either the lessor or the lessee may be the assessee (Section 405). Typically if the lease is a true lease, the lessor is considered the owner. The facts specific to each case determine the assessee.

Sales and Use Tax. Under California's Sales and Use Tax Law (Part 1, Division 2 of the Revenue and Taxation Code, commencing with Section 6001), except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. Where sales tax does not apply, such as when the sale takes place outside the state, use tax is imposed, measured by the sales price of property purchased from a retailer for the storage, use, or other consumption of property inside this state.

Under the law, any lease of tangible personal property in any manner whatsoever for a consideration is a "sale" and a "purchase" under the Sales and Use Tax Law (except for certain items not relevant here). Generally, a lease of tangible personal property is regarded as a continuing "sale" and a continuing "purchase" for purposes of the law, and the use tax (not the sales tax) applies to the amount of rentals paid. The lessor is required to collect the use tax from the lessee at the time the rentals are paid by the lessee. However, no sales or use tax is due with respect to the lease or rental amount charged for tangible personal property leased in substantially the same form as acquired by the lessor in situations in which the lessor has paid sales tax reimbursement or has paid use tax on the lessor's purchase price. If the tax has not been so paid, and the lessor desires to pay tax on the purchase price, the lessor must report and pay the tax timely on his or her sales and use tax return for the period during which the property is first placed in rental service. Otherwise, the use tax is due on the rental receipts.

Under various provisions of the Revenue and Taxation Code, and Article XIII of the State Constitution, the statewide sales and use tax rate of 7.25% is generally imposed on sales and purchases of tangible personal property in this state (including leases of heavy equipment that are "continuing sales" and "continuing purchases," unless specifically exempted from the tax). This 7.25% is made up of the following components (additional transactions and use taxes, also known as "district taxes," ranging from 1/8% to 2.5% are levied in various local jurisdictions and are not reflected in this chart):

Rate	Jurisdiction	Purpose/Authority
5.00%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

Although the Sales and Use Tax Law provides no specific exemption from the tax for leases of heavy equipment, certain leases of farm machinery and equipment under Section 6356.5, and timber harvesting equipment under Section 6356.6, which may be regarded as “heavy equipment” as that term is defined in this bill, and are currently excluded from the imposition of use tax.

PROPOSED LAW

This bill adds Part 11 (commencing with Section 5500) to Division 1 of the Revenue and Taxation Code to impose a tax, in lieu of any property tax, on every qualified lessee of qualified heavy equipment, as defined, at a rate of 1.25% of the gross receipts. The bill requires the lessor of that equipment to collect the tax, and requires the BOE to administer the tax. Among its provisions, the bill:

- Requires the revenues be paid to the BOE quarterly on or before the last day of the month following each quarterly period, and requires the revenues be deposited in the Heavy Equipment Revenue Fund, created by this bill, for appropriation by the Legislature to reimburse local entities for their loss of property tax revenues.
- Defines a “qualified lessee” as a lessee that leases or rents qualified heavy equipment from a qualified lessor.
- Defines a “qualified lessor” as a lessor (1) whose principal business is the short-term lease or rental (defined as a period of 365 days or less) of qualified heavy equipment, (2) that has a (unspecified) percentage of the total gross receipts of the lessor’s business that is derived from the lease or rental of qualified heavy equipment, and (3) is engaged in a line of business described in the North American Industry Classification System Industry 532412, as specified.
- Defines “heavy equipment” to mean construction, earthmoving, or industrial equipment that is *mobile*, including attachments for the equipment, including, but not limited to the following:
 - (1) A self-propelled vehicle that is not designed to be driven on the highway.
 - (2) Industrial electrical generation equipment.
 - (3) Industrial lift equipment.

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(4) Industrial material equipment.

- Requires that the proposed tax be administered in accordance with the Fee Collection Procedures Law.
- Specifies that the tax shall be in lieu of any property tax on qualified heavy equipment.

The bill would go into immediate effect, but the imposition of the tax would commence on and after January 1, 2013.

COMMENTS

1. **Sponsor and Purpose.** We are awaiting confirmation from the author's office. It is our understanding that the rental industry has been seeking a heavy equipment gross receipts tax in lieu of the personal property tax across the nation.
2. **In lieu of personal property taxation.** Because qualified heavy equipment is classified as personal property, there is no legal impediment to transferring assessment from local county assessment to a State agency such as the BOE provided the voting threshold of two-thirds is achieved. Section 2 of Article XIII of the California Constitution provides that the Legislature, two-thirds of the membership of each house concurring, may classify personal property for differential taxation or for exemption. For example, the vehicle license fee is in lieu of the property tax pursuant to Revenue and Taxation Code Section 10758. Vehicles were transferred from local county assessment to the Department of Motor Vehicles via the creation of the vehicle license fee in 1936. The change in taxation methods stemmed from the inability to effectively assess and collect taxes on vehicles via the property tax. With respect to vehicles, noted problems at that time included significant levels of tax evasion by taxpayers, relatively high administrative costs, and a lack of statewide uniformity in the values assigned to similar vehicles.
3. **Who is a "qualified lessor?"** The bill in part defines a qualified lessor as one that is engaged in a business described in NAICS Industry Code 532412. This code describes establishments that are primarily engaged in a line of business renting or leasing heavy equipment without operators that may be used for construction, mining, or forestry, such as bulldozers, earthmoving equipment, oil well or other well-drilling machinery and equipment, logging, or cranes.
4. **Establishing "qualified lessor" status.** A condition for establishing qualified lessor status is that a yet to be determined percentage of gross receipts must be derived from qualified heavy equipment. The bill is silent as to when and how that status is to be determined. Does the property in question default from year to year between the property tax and the heavy equipment tax if the threshold percentage is not reached? Does the BOE redetermine qualified status each year? Or each quarter? For example, what happens if the percentage changes from quarter to quarter within the same calendar year? Unlike real property, personal property is subject to property tax for the upcoming fiscal year (July 1 to June 30) only if taxable on January 1. There are no mid-year or pro-rata assessments. Thus, should the lessor become no longer qualified after January 1, there is no mechanism to make the heavy equipment subject to the property tax until the following January 1.

5. **What does “mobile” and “heavy” mean?** The bill defines “heavy equipment” to mean construction, earthmoving, or industrial equipment that is *mobile*. The bill further provides examples of such equipment, such as industrial lift or material equipment and industrial electrical generation equipment. However, in order to clearly identify the sorts of property that would be subjected to the proposed tax, it is suggested that a more comprehensive definition of “mobile” be provided in the bill consistent with the author’s intent. For example, some light duty drilling rigs are similar to mobile cranes, and certain land rigs must be broken apart into sections and loads to move to a new place, a process which can often take weeks. Would the light duty rigs not be qualifying “heavy equipment” notwithstanding the fact that they are mobile? Would the heavier land rigs not be subjected to the tax because they are not regarded as mobile?
6. **The bill should define “gross receipts.”** The bill would impose the tax on the gross receipts from the lease or rental of the equipment. Since “gross receipts” could include a variety of charges, such as applicable use tax, late charges and interest for untimely rental payments, insurance charges, charges for damages to the property, insufficient fund fees, etc., the bill should provide a specific definition consistent with the author’s intent.
7. **The imposition of tax on out-of-state lessors, out-of-state lessees, and out-of-state usage of property should be addressed.** Since the bill imposes the tax on the lessee, would the tax apply if the lessee uses the equipment outside this state? If a lessor is out-of-state, but the equipment is leased to a lessee in California, would the lessor be required to collect the tax?
8. **Use tax revenues would decrease.** Under the Sales and Use Tax Law, amounts paid for personal property taxes on continuing “sales” and continuing “purchases” of leased property, whether assessed directly against the lessee or against the lessor are subject to the use tax. By eliminating the property tax on the “heavy equipment” as proposed in this bill, the base upon which the use tax would be imposed on these leases of heavy equipment would be reduced, thereby having a negative impact on the state and local use tax revenues.
9. **For affected taxpayers, this could complicate reporting.** For property tax purposes, one taxpayer may have both qualified heavy equipment and non-qualified equipment, in addition to other property still subject to assessment at the county level. Another taxpayer may have a combination of both short term (subject to the proposed tax) and long term leases (subject to the property tax). In addition, for sales and use tax purposes, lessors of heavy equipment are currently required to hold seller’s permits, file returns, and report the applicable sales or use tax on their sales and leases of heavy equipment. This combination of taxes would require separate accounting records for purposes of reporting values for property tax purposes to the county assessor, reporting sales and use tax on leased property, and properly reporting the proposed tax to the BOE.
10. **Delayed operative date necessary.** To effectively implement this bill, it would be necessary for the BOE to notify and register qualified lessors, develop computer programs, hire and train key staff, create necessary forms and schedules, and answer taxpayer inquiries. These functions should take place before the tax becomes operative.

BOE staff estimates that it would take a minimum of six months to implement the new program proposed by this bill. In order to provide the BOE with the necessary 6-month lead time, it is suggested that the bill be amended to provide for a delayed operative date to the first day of the first calendar quarter commencing more than six months after the bill is enacted. This would provide the BOE with sufficient lead time to successfully implement the bill and would be consistent with the quarterly reporting basis proposed by this measure.

- 11. How would the BOE be funded for administrative costs?** This bill proposes a tax to be imposed beginning January 1, 2013. In order to notify and register taxpayers, develop computer programs and reporting forms, and hire appropriate staff, an adequate appropriation would be required to cover the BOE's administrative costs that would not already be identified in the BOE's 2012-13 budget.

Typically, the BOE would seek payment from the Heavy Equipment Revenue Fund for administrative start-up costs through the budget change proposal (BCP) process. However, the Fund would not have a balance to reimburse the BOE's administrative start-up costs prior to the collection of the tax. To address this funding issue, this bill should be amended to add language authorizing a loan from the General Fund, or other eligible fund, to the Fund, to be repaid from taxes collected.

Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the proposed tax program. Without an appropriation for administrative start-up costs, the BOE would have to divert General Fund dollars to the proposed tax program, which would have a negative impact on the revenues of State and local government.

Furthermore, the bill does not specify funding for the BOE's on-going administrative costs. The following amendment is suggested to clarify the BOE's funding for on-going administrative costs:

5508. (a) All revenues, interest, penalties, and other amounts collected pursuant to this part, less refunds and the board's costs of administration, shall be deposited in the Heavy Equipment Revenue Fund, which is hereby established in the State Treasury.

(b) Upon appropriation by the Legislature, revenues in the fund shall be used to reimburse local entities for their loss of property tax revenues resulting from ~~the~~ of the act that added this subdivision.

- 12. Electronic registration.** All new programs administered by the BOE should comport with the BOE's electronic services projects and activities, which include, in part, internet registration and the transition to e-filing. The bill requires electronic filing, but does not require electronic registration. The following language is suggested to be added to the bill:

5506.5. Every qualified lessor required to collect the tax imposed under this part shall register with the board. Every application for registration shall be made upon a form prescribed by the board and shall set forth the name under which the applicant transacts or intends to transact business, the location of his or her place or places of business, and such other information as the board may require. An application for an account shall be authenticated in a form or pursuant to methods as may be prescribed by the board.

13. **End user tax.** Generally when a tax or fee is imposed upon an end user, the tax or fee is required to be separately stated on the receipt or other invoice provided to the consumer. This provides the person upon whom the tax is imposed with documentation that the tax or fee has been paid, relieving them of further liability. If the intent of this measure is to not extinguish the lessee's liability until the tax is paid to the lessor, the author may also wish to consider amending the bill to:
- Require the tax be separately stated on the invoice or other sales documentation provided to the lessee;
 - Clearly identify liability for the tax (e.g. Revenue and Taxation Code Section 40018); and
 - Relieve a qualified lessor from the liability to collect the tax for accounts found worthless and charged-off for income tax purposes.
14. **Overlapping state and local jurisdictions.** Because counties still have to assess other personal property owned by qualified lessors and subject to the property tax, this bill could create an additional level of complexity for counties in performing their assessment and audit functions. Counties would have to distinguish between qualified heavy equipment and other equipment. Overlapping state and local jurisdictions requires clear delineation, identification, and reporting of the property for taxing officials and taxpayers otherwise the potential for double taxation and escaping taxation exists. A bright-line that clearly defines property subject to the proposed tax is necessary to eliminate these issues and/or disputes between assessors and property owners (as well as between assessors and the BOE).
15. **Could a qualified lessor manipulate their inventory in such a way as to minimize both their gross receipts and their property tax liability?** For instance, there does not appear to be a requirement that each piece of equipment be maintained in rental inventory. Therefore, could a qualified lessor who also had a related entity convert a short term rental of heavy equipment into personal use after the lien date and avoid the personal property tax while at the same time minimizing the gross receipts tax because the property would not be rented for the remainder of the year?
16. **Changes in tax burden and revenue allocation.** Under current law, qualified heavy equipment not leased or rented on January 1 could be exempt pursuant to the business inventory exemption. Such property would no longer be exempt under a gross receipts tax. If qualified heavy equipment is taxable, then depending on the facts of each circumstance, it could be taxed to the lessee or the lessor, which in turn determines the flow of revenue to local jurisdictions. Furthermore, depending on whether the rental or lease is for a period of six months or less, then pursuant to Property Tax Rule 10, the valuation for tax purposes could vary dependent on the trade level (manufacturer, wholesaler, retailer, or consumer.) Thus, under the property tax, who pays the tax, the value on which that tax is based, and the allocation of the revenues to local jurisdictions can be variable factors.
17. **Reimbursement to school districts, community college districts and county superintendent of schools?** This bill defines "local entity" as a city, county, and special district and upon appropriation from the Legislature reimburses these local entities for their loss of property tax revenues. Would these other jurisdictions that currently receive property tax revenues be reimbursed for their loss as well?

18. Technical corrections. It appears on page 3, line 29, “lessee” should be replaced with “lessor.” In addition, the reference to “State Board of Equalization” should be replaced with “board” throughout the bill since that term is defined in Revenue and Taxation Code Section 20 to mean the State Board of Equalization and that definition applies to any portion of the Revenue and Taxation Code.

COST ESTIMATE

The BOE would incur non-absorbable costs to adequately develop and administer a new tax program. Costs could be related to identifying and registering affected taxpayers, developing related computer programs, processing returns, payments, and claims for refunds, and carrying out compliance and audit efforts to ensure proper reporting, along with developing regulations, training staff, and answering inquiries from the public. These estimated costs are pending.

REVENUE ESTIMATE

Pending.

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