♦ Sales and Use Tax

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♦ SALES AND USE TAX—OVERVIEW

This section provides information on tax expenditure programs (TEPs) associated with the sales and use tax paid by individuals and businesses. These TEPs affect the amount of General Fund and special funds revenues raised by the sales and use tax, the second largest source of state revenues. These TEPs also have an impact on local government revenues since (except in certain instances) the programs affect both the state and local portions of sales and use tax receipts. The following provides a brief description of this tax.

GENERAL BACKGROUND INFORMATION

The sales and use tax is levied on the gross receipts of personal property sold or transferred to an individual or business considered to be the final consumer. The sales and use tax actually consists of *two* complementary taxes:

- Sales Tax. The sales tax portion is the more familiar of the two taxes and is levied on the total purchase price of tangible personal property sold in California, except for items specifically exempted from taxation by law.
- *Use Tax.* In contrast, the *use* tax generally applies to the storage, use, or other consumption in this state of goods purchased from retailers in transactions not subject to the sales tax, generally for purchases shipped into California from another state.

The following example is helpful in demonstrating how the use tax works. If an automobile is purchased in Oregon by a California resident who intends to use the vehicle in California, then the individual would pay the California use tax on the retail price of the car. Without a use tax, such a consumer could avoid paying a tax on a vehicle to be used within California, by purchasing it outside the state and then bringing it into California. State automobile registration requirements make feasible the collection of the use tax on vehicles brought in from out of state. Central registration requirements also facilitate the collection of use tax for water vessels, aircraft, and mobilehomes. For other types of purchases, registered taxpayers involved in sales activities are required to report taxable outof-state purchases on their quarterly sales and use tax returns.

Collection Responsibility. A seller is responsible for remitting the sales and use tax to the state, although he/she may try to "pass" the tax on to the purchaser through higher prices. The extent to which the sales and use tax is passed on to the purchaser through higher prices is dependent on the supply and demand characteristics of the particular commodity and market involved. Regardless of who bears the ultimate financial burden or "incidence" of the tax, however, the seller is legally responsible for collecting and remitting all tax payments to the Board of Equalization (BOE), the state agency in charge of administering the sales and use tax.

CHARACTERISTICS OF THE CALIFORNIA SALES AND USE TAX

Tax Rate. The sales and use tax was first imposed in California in 1933. The tax rate has generally increased since that time, although there have been periodic decreases as well. Additions and subtractions to the sales and use tax base have also taken place through changes in exempted transactions.

The basic sales and use tax rate consists of both a *state* rate and a *local* rate. Figure 1 provides a breakdown of the current tax rate levied in California.

Figure 1	
Sales and Use Tax Rates	
State	
General Fund	5.00%
Local Revenue Fund	.50
Local Public Safety Fund	.50
Subtotal	6.00%
Local	
Uniform Local Taxes (Bradley-Burns)	1.25%
Optional Local Taxes ^a	1.50
Subtotal	2.75%
Total	8.75%
Maximum optional local rate, except for San Francisco City and County (1.75 percent), San Mateo County (2 percent), and San Diego County (1 percent). Source: Board of Equalization	

• State Tax Rate. The current state sales and use tax rate is 6 percent. As Figure 1 shows, 5 percent of the state sales and use tax rate is dedicated to the General Fund. In addition, a 0.5 percent rate is dedicated to the Local Revenue Fund, which is earmarked for health and welfare costs associated with the 1991 state-local government realignment program. A second 0.5 percent state tax levy is

- dedicated for local public safety programs and is allocated directly to localities through the Local Public Safety Fund. Figure 2 summarizes how the state's General Fund tax rate has changed from the mid-1930s to the present.
- **Local Tax Rate.** As shown in Figure 1, the Bradley-Burns Uniform Local Tax is a 1.25 percent levy, consisting of a 1 percent tax that is allocated to local governments for general purposes and a 0.25 percent levy that is dedicated for county transportation purposes. Localities also have the option of imposing, with voter approval, up to a 1.5 percent transactions and use tax. (San Francisco City and County and San Mateo County, however, are allowed to exceed this maximum rate by 0.25 percent and 0.5 percent, respectively.) Some of these local revenues may be used for general purposes, but they have primarily been imposed for transportation-related purposes.

State Sales and Use Tax Rates (General Fund)

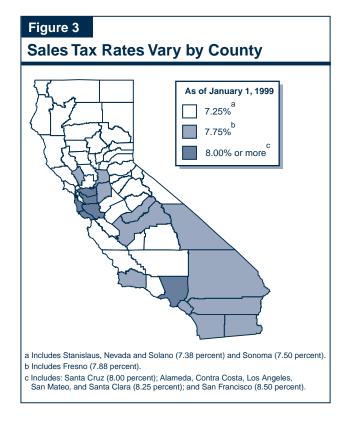
	Tax Rate
1933-34	2.50%
1935-42	3.00
1943-48	2.50
1949-66	3.00
1967-71	4.00
1972	3.75
1973	4.75
1973	3.75
1974-90	4.75
1991-92	5.50
1993 to present	5.00
Source: Board of Equalization	

Given the above, the combined state-local sales and use tax rate in California varies by county. As shown in Figure 3, actual rates as of January 1, 1999, ranged from a low of 7.25 percent to a high of 8.5 percent. The estimated revenue reductions shown in the following TEP reviews include effects on both the state and local governments.

Tax Base. The sales and use tax base consists of all items that are potentially taxable under current law, minus various exemptions and exclusions (the latter are discussed in detail in the reviews that follow). In general, any tangible asset that is moveable (that is, not permanently attached to property) which is sold and subsequently used, consumed, or stored in California is subject to the sales and use tax. However, there are some general exceptions to this rule, including the following:

- Federal Government Purchases. The federal government, its agencies and instrumentalities that are deemed wholly owned by the federal government, various federally related contract activities, and the American Red Cross, are exempt from state and local sales and use taxes.
- Out-of-State Sales. Goods delivered to an out-of-state purchaser for use outside of California are exempt from California's state and local sales and use taxes.
- **Resale Purchases.** Goods purchased by a business which are subsequently resold as part of an intermediary transaction are exempt from the state and local sales and use tax. This includes both certain materials that will be *incorporated* into a final product, and finished products purchased for *resale* (such as furniture or artwork purchased by an interior designer that will be resold to clients).

While items purchased outside of California and transported into and used within the state *are* technically *subject* to the use tax, only



in cases where there are centralized registration requirements or the purchases are made by registered sales tax payers does the state actually *collect* the tax. For example, no use tax is collected from individuals who purchase goods through mail-order, Internet, or other related means.

In addition, California generally does not directly tax services when these represent the final product (although there are a limited number of exemptions to this general rule, such as photocopying services and gift wrapping services). However, services that contribute to the production or delivery of a tangible product sold are *indirectly* subject to the sales and use tax through the explicit or implicit incorporation of the cost of such services in the price of the tangible product. Such services include, for example, food service at restaurants and assembly and delivery activities.

Sales and Use Tax—Overview	

GAS, ELECTRICITY, WATER, STEAM, AND HEAT

	Program Characteristics	
Тах Туре:	Sales and Use Tax.	(1
Authorization:	California Revenue and Taxation Code Section 6353.	1

enue Reduction		
·		
Amount		
\$3,000		
3,156		
1998-99 3,264		

DESCRIPTION

This program exempts from taxation the sale or transfer of gas, electricity, water (including steam), and geothermal brines or other heat sources delivered through mains, lines, or pipes. It also exempts water sold to an individual in bulk quantities (50 gallons or more) for household use, when the residence is not served by mains, lines, or pipes. In addition, the program exempts the transfer of steam, heat, or other energy produced by cogeneration technologies.

RATIONALE

The basic exemption for gas, electricity, and water dates back to the inception of the sales tax in 1933, when companies providing these services were subject to a gross receipts tax that was levied in lieu of other taxes under the State Constitution. The original tax exemption merely recognized that the Constitution prohibited the imposition of other taxes, such as the sales tax, on these companies. Although these constitutional provisions were subsequently repealed, the exemption nevertheless remained in effect.

Currently, there are two apparent rationales for this program. First, gas and electric bills are subject to municipal utility user taxes in many cities, often at rates higher than the sales tax rate. Thus, it is argued by some that the sales tax exemption avoids subjecting gas and electricity to double taxation.

Second, this program provides tax relief to consumers of gas, electricity, and water to the extent that sales and use taxes normally would be incorporated into the prices charged for these items. Proponents argue that these utilities provide basic and necessary services and, as such, such services should not be made any more costly to consumers by imposing the sales tax on them.

The exemption, however, is not limited to residential gas and electricity service. Rather, it also includes commercial and industrial purchases of electricity and natural gas, to which the "necessity of life" rationale does not apply.

COMMENTS

Cities were receiving around \$700 million from utility user taxes as of the late 1980s, but counties were not permitted to impose such levies. However, legislation at the start of the 1990s (Chapter 466, Statutes of 1990 [SB 2557, Maddy]) extended to counties the authority to levy such utility user taxes. In 1995-96, cities and counties raised approximately \$1.3 billion from the utility users tax.

It is not clear that electricity, which is not a physical object or substance, would be subject to sales taxation even in the absence of this program.

ORGANIC PRODUCTS GROWN EXPRESSLY FOR FUEL PURPOSES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358.1 (a)(1).

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	Minor	
1997-98	Minor	
1998-99	Minor	

DESCRIPTION

This program exempts from taxation the sale or transfer of organic products grown expressly for fuel purposes.

RATIONALE

This program provides an incentive for the production and use of organic products as fuel. It accomplishes this to the extent that it reduces the cost of buying or using organic fuels, thereby making them more attractive relative to conventional fuel sources. The apparent underlying rationale for the program is to reduce the economy's reliance on depletable fossil fuels—especially crude oil—and to encourage profitable alternative uses of farmland.

COMMENTS

Grain purchases by an alcohol producer generally would be exempt, even in the absence of this program, as a purchase for resale. However, growers of organic products, such as wood, that are sold for direct use as fuel *do* benefit from this program.

A detailed review of this program appeared in Volume I, Part Two, of our *Analysis of the 1987-88 Tax Expenditure Budget*. This review recommended that the program be maintained on the basis of (1) tax equity (since competing energy sources are not taxed), and (2) administrative savings to the Board of Equalization from not having to establish taxable values for the exempt items.

AGRICULTURAL, TIMBER, MUNICIPAL, AND INDUSTRIAL WASTE BY-PRODUCTS

Program Characteristics		
Tax Type:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6358.1 (a)(2).	

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or transfer of qualified waste by-products from (1) agricultural and forest-products operations, (2) municipal refuse, and (3) manufacturing activities. In order to qualify, these by-products must be used as fuel in an industrial facility in lieu of either oil, natural gas, or coal.

RATIONALE

This program provides an incentive for industry to use waste by-products as an alternative fuel. It accomplishes this to the extent that it reduces the cost of buying or using waste by-product fuels, thereby making them more economically attractive relative to conventional fuel sources. The underlying rationale for the program is to reduce the economy's reliance on fossil fuels, especially crude oil, and to encourage the more effective and complete utilization of scarce resources. The program also equalizes the taxation of waste-fuel materials that are purchased with those that are self-generated.

COMMENTS

This program was established by Chapter 1248, Statutes of 1980 (SB 1576, Nielsen), and was permanently extended by Chapter 254, Statutes of 1986 (SB 1083, Boatwright). The program was amended by Chapter 1059, Statutes of 1983 (SB 1031, Boatwright) to delete the original requirement that qualifying by-products be "delivered in bulk." This change ensured that the program would apply to waste by-products consumed at the same site where they are generated, such as the burning of wood chips in a lumber mill.

A detailed review of this program appeared in Volume I, Part Two, of our *Analysis of the 1987-88 Tax Expenditure Budget*. This review recommended that the program be maintained on the basis of tax equity (since competing sources of fuel are not taxed), and the administrative savings to the Board of Equalization from not having to establish taxable values for the exempt items.

USE OF REFINERS' GAS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358.1 (b).

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99 NA		

DESCRIPTION

This program exempts from taxation the use of "still gas" which has been produced as a by-product during the refining of purchased crude oil.

RATIONALE

The underlying rationale for the program is to equalize the tax treatment of still gas used by refiners who purchase their crude oil, with those who use oil they produce themselves. It is agrued that the program also encourages resource conservation through more efficient use of crude oil supplies.

COMMENTS

The use of still gas produced from proprietary (that is, nonpurchased) petroleum is not subject to the use tax, because state law re-

quires that a formal transfer of a product occur in order to "trigger" a tax levy.

This program was established by Chapter 1059, Statutes of 1983 (SB 1031, Boatwright), as declarative of existing law under Chapter 1248, Statutes of 1980 (SB 1576, Nielsen), which provided a tax exemption for waste by-products derived from manufacturing activities. This program was permanently extended by Chapter 254, Statutes of 1986 (SB 1083, Boatwright).

A detailed review of this program appeared in Volume I, Part Two, of our *Analysis of the 1987-88 Tax Expenditure Budget*. This review recommended that the program be maintained on the basis of tax equity (since competing sources of fuel are not taxed) and the administrative savings to the Board of Equalization from not having to establish taxable values for refiners' gas.

ANIMAL LIFE

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358 (a).

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	\$43	
1997-98	46	
1998-99	47	

DESCRIPTION

This program exempts from taxation the sale or transfer of animal life, the products of which ordinarily constitute food for human consumption.

Purchases of dairy cows and of any livestock or poultry for breeding (or egg laying) purposes ordinarily would be subject to sales and use taxes in the absence of this program. This is because these animals are put to use by the purchaser, rather than simply fattened and resold, as with most beef cattle.

RATIONALE

This program provides tax relief to producers of animal-based food products, by eliminating the sales and use taxes that ordinarily would apply to animals that are not purchased solely for resale. By reducing the cost of producing animal-based food items, the program benefits consumers to the extent that these lower production costs reduce retail food prices. As such, this program basically is an extension of the sales and use tax exemption for food. The underlying rationale offered for the program is that food is a basic necessity of life, and that its price should not be increased by taxation.

ANIMAL FEED

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358 (b).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$191
1997-98	201
1998-99	207
	207

DESCRIPTION

This program exempts from taxation any sale or transfer of animal feed which is fed to qualified animals. Qualified animals are those whose products either ordinarily constitute food for human consumption, or are to be sold in the regular course of business.

RATIONALE

This program provides two basic types of tax relief. First, it provides tax relief to consumers of animal-based food products by reducing the prices of these products. As such, this aspect of the program basically is an extension of the sales and use tax exemption for food. The underlying rationale offered for

this aspect of the program is that food is a basic necessity of life, and its price, therefore, should not be increased by taxation.

The second type of tax relief provided by the program is to consumers of *non*food animal products, to the extent that sales and use taxes on feed ordinarily would be incorporated into these products' prices. The rationale offered here is that feed is a "component part" of an item which subsequently is itself subject to taxation and, therefore, should not be double-taxed. An example is the use of feed to raise animals, the pelts of which are used to make coats, which in turn are subject to sales taxes.

SEEDS AND PLANTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358 (c).

Estimated Revenue Reduction	
Amount	
\$24	
25	
30	

DESCRIPTION

This program exempts from taxation the sale or transfer of seeds and plants whose products either ordinarily constitute food for human consumption, or are to be sold in the regular course of business.

RATIONALE

This program provides two basic types of tax relief. First, it provides tax relief to consumers of seed and plant-related food products by reducing their prices. As such, this aspect of the program basically is an extension of the sales and use tax exemption for food. The underlying rationale for this aspect of the program is that food is a basic necessity of life and its price, therefore, should not be increased by taxation.

The second type of tax relief provided by the program is to consumers of *non*food products that are derived from qualifying seeds and plants, to the extent that sales and use taxes ordinarily would be incorporated into the prices of these seeds and plants. The rationale here is that these items are "component parts" of products which, themselves, are subsequently taxed and, therefore, should not be subjected to double taxation. An example is the purchase of flower seeds by a nursery in order to grow flowers, which themselves are taxed when sold to consumers.

COMMENTS

Chapter 323, Statutes of 1998 (AB 2798, Machado), extended this sales tax exemption, formerly limited to annual plants, to perennial plants.

QUALIFIED FERTILIZER

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358 (d).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$48
1997-98	50
1998-99	52

DESCRIPTION

This program exempts from taxation the transfer of fertilizer to be used on land, if the land is used to produce either food for human consumption or other products to be sold in the regular course of business.

RATIONALE

This program provides two basic types of tax relief. First, it provides tax relief to consumers of food products grown with the help of fertilizer, by reducing their prices. As such, this aspect of the program basically is an extension of the sales and use tax exemption for food. The underlying rationale offered for this aspect of the program is that food is a basic necessity of life, and its price, therefore, should not be increased by taxation.

The second type of tax relief provided by the program is to consumers of *non*food products which fertilizer helps produce, to the extent

that sales and use taxes on fertilizer ordinarily would be incorporated into these products' prices. The underlying rationale offered here is that the fertilizer is a "component part" of an item which subsequently is, itself, subject to taxation and, therefore, should not be double-taxed. An example is the use of fertilizer by a nursery in growing flowers, which themselves are taxed when sold to consumers

COMMENTS

For the purposes of this program, the term "fertilizer" includes commercial fertilizers, agricultural minerals, and manures, but does not include soil amendments. The latter are excluded on the basis that they do not constitute a "component part" of the grown products, but rather are capitalized into land values. Such soil amendments include hay, straw, peat, leaf mold, sand, potting mediums, and specified mineral and chemical constituents.

POULTRY LITTER

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358.2.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$1
1997-98	1
1998-99	1

DESCRIPTION

This program exempts from taxation the sale or use in California of certain products that are used as litter in poultry and egg production and that in turn are ultimately resold as, or incorporated in, fertilizer products. This exemption applies to wood shavings, sawdust, rice hulls, or other related products.

RATIONALE

This program provides two types of tax relief. First, it provides tax relief to consumers that purchase fertilizer products. Second, it provides indirect tax relief to consumers of food and nonfood products which fertilizers help to produce, again to the extent that the product prices would reflect the sales and use tax paid on the components incorporated in the fertilizers. Program proponents note that the program is consistent, at least to some extent, with the related program for qualified fertilizer.

FOOD PRODUCTS

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization:	California Constitution, Article XIII, Section 34, and California Revenue and Taxation Code Sections 6359, 6359.2, and 6359.4.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	\$2,480
1997-98	2,609
1998-99	2,698

DESCRIPTION

This program generally exempts from taxation the transfer of food products for home consumption (other than carbonated or alcoholic beverages). The program does not extend to sales of most prepared food, including take-out food items and restaurant meals.

Special rules apply to vending machine sales of otherwise nontaxable food items, such as candy. Generally, 33 percent of the receipts from these sales are taxed as an approximation of the portion of these sales that otherwise would be taxable because they are items consumed on the same premises as the vending machine. Vending sales of any food item costing 15 cents or less, or of any bulk food items (such as nuts) costing 25 cents or less, are fully exempt from taxation. This is accomplished by treating these retailers as the consumers of the items that they sell. Since the food products are exempt when purchased by the vendor (under the general food exemption), this treatment is equivalent to a full tax exemption.

RATIONALE

This program provides tax relief to consumers of food products, by reducing their price. The underlying rationale put forth for the

program is that food is a basic necessity of life and, therefore, its price should not be increased through the application of the sales tax.

COMMENTS

Although the basic rationale offered for this program is to exempt food products from taxation because they are a necessity of life, it should be noted that the term "necessity" is somewhat loosely, and even inconsistently, applied. For example, restaurant meals and most take-out foods are taxed. This treatment generally is justified on the grounds that they are luxuries, or at least a convenience, compared with cooking at home. However, some of these taxable foods also appear to be necessities, if purchased by an individual lacking cooking facilities.

In addition, in the case of food products that qualify under this program, there is no attempt to restrict the quality or cost of exempted items. For instance, the program applies to high-grade or expensive products, which do not constitute basic necessities.

In 1991, the Legislature passed legislation that would levy the sales and use tax on snack foods. "Snack foods" were defined to

include products that were sold in a condition suitable for immediate consumption, such as cookies, potato chips, and snack cakes. The legislation (Chapter 85, Statutes of 1991, [AB 2181, Vasconcellos] and Chapter 88, Statutes of 1991, [SB 179, Deddeh]) met with some resistance and confusion among tax-

payers and retailers, especially with regard to certain apparent inconsistencies. For example, pre-popped popcorn was subject to taxation but unpopped popcorn was not. The so-called "snack tax" was repealed by Proposition 163, approved by the voters in November 1992.

CANDY, GUM, AND CONFECTIONERY PRODUCTS

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization:	California Constitution, Article XIII, Section 34, and California Revenue and Taxation Code Section 6359(b).

Estimated Revenue Reduction		
(In Millions)	(In Millions)	
Fiscal Year	Amount	
1996-97	\$199	
1997-98	210	
1998-99	217	

DESCRIPTION

This program generally exempts from taxation the sale or use of candy, gum, and other confectionery products for home consumption. This program is included within the overall food exemption and is subject to the same limitations. Vending machine sales of candy, gum, and other confectionery products may be subject to tax under certain conditions (see discussion under the previous program entitled "Food Products").

RATIONALE

This program provides tax relief to producers of candy and to candy consumers by reduc-

ing the prices of such products. The program's rationale is that candy, gum, and confectionery items also constitute food products and as such, deserve the same tax exemption granted for food generally.

This exemption was repealed effective July 15, 1991 as part of a broadening of the sales and use tax base. The exemption was reinstated in November 1992 as part of Proposition 163 and was incorporated into the California Revenue and Taxation Code Section covering food products.

BOTTLED WATER

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Constitution, Article XIII,

Section 34, and California Revenue and Taxation Code Section 6359(b).

Fiscal Year	Amount
1996-97	\$85
1997-98	90
1998-99	93

Estimated Revenue Reduction

(In Millions)

DESCRIPTION

This program exempts from taxation the transfer or use of noncarbonated and non-effervescent bottled water.

RATIONALE

This program provides tax relief to the consumers of bottled water. The underlying rationale offered for the program is that water is a basic necessity of life. Many individuals use bottled water because of impurities and other related problems with the quality of their normal water supplies.

COMMENTS

The statute allowing the exemption (California Revenue and Taxation Code Section 6359[b]) was repealed effective July 15, 1991 as part of a broadening of the sales and use tax base. The exemption was reinstated as part of Proposition 163 in November 1992, and was incorporated into the California Revenue and Taxation Code Section covering food products (see previous program entitled "Food Products").

PACKING ICE AND DRY ICE

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6359.7.

Estimated Revenue Reduction		
(In Millions)	(In Millions)	
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99	NA	

DESCRIPTION

This program exempts from taxation the transfer of ice and dry ice, when the ice is used or employed in packing and shipping qualified food products for human consumption by qualified carriers.

RATIONALE

Proponents of this program argue that it is needed to equalize the tax treatment of packing ice and dry ice with that of various other competing cooling processes. These various other means of cooling (such as forced air and chilled water baths) are not directly subject to sales and use taxation because they are "processes" and not tangible personal property (as is ice). The program also has been rationalized on the grounds that coolants are needed to provide consumers with unspoiled food products, many of which are, themselves, exempt from taxation because they are viewed as basic necessities of life.

COMMENTS

This program became operative on January 1, 1986 as provided by Chapter 1045, Statutes of 1985 (AB 1887, Areias). An earlier program had been in effect for ice used in interstate transportation only, until its repeal in 1979 by Chapter 1150, Statutes of 1979 (AB 66, Lockyer).

The rationale that this program is needed to equalize the tax treatment of ice with that of other cooling methods overlooks the fact that the equipment for these alternative coolant systems generally is subject to sales and use taxation at the time it is purchased. A detailed review of this program appeared in Part Two of our *Analysis of the 1988-89 Tax Expenditure Budget*. In our review, we found no evidence that this program was having any significant impacts on the basic economic competitiveness of the affected California industries, or on prices paid by consumers. Accordingly, in the interests of tax equity, we recommended that this program be repealed.

CARBON DIOXIDE USED IN PACKAGING

Tax Type: Sales and Use Tax.

California Revenue and Taxation Code

Section 6359.8.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

Authorization:

This program exempts from taxation the sale or use of carbon dioxide used in packing, shipping, or transporting fruits or vegetables for human consumption, provided that the fruits and vegetables are not sold with the carbon dioxide packaging and any nonreturnable materials containing carbon dioxide. To qualify for the exemption, the fruits or vegetables must be shipped or transported in the carbon dioxide packaging by common carriers, contract carriers, or proprietary carriers.

RATIONALE

This program provides tax relief to consumers of fruits and vegetables that have been packed and shipped. The underlying rationale for the program is that food products such as fruits and vegetables are basic neces-

sities of life, and therefore, their price should not be increased through taxation. This program also attempts to equalize tax treatment of carbon dioxide packaging with other types of packaging (such as dry ice and forced air) that are used to provide consumers with unspoiled food products. These alternative types of packaging also are exempt from taxation as described under separate programs.

COMMENTS

As discussed in the program entitled "Packing Ice and Dry Ice," this program may result in a tax advantage of exempt methods over certain other cooling methods. While cooling methods such as forced air and chilled water are not *directly* taxed, the equipment for these coolant systems *is* generally taxed when purchased.

PRESCRIPTION MEDICINES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6369 and 6369.1.

(In Millions) Fiscal Year Amount 1996-97 \$652 1997-98 686 1998-99 709	Estimated Revenue Reduction (In Millions)	
1996-97 \$652 1997-98 686		
1997-98 686	Fiscal Year	Amount
	1996-97	\$652
1998-99 709	1997-98	686
	1998-99	709

DESCRIPTION

This program exempts from taxation the sale or use of specified medicines and medical-related products used for treating the health problems of human beings. Items which qualify for the program include medicines which are: (1) prescribed by a physician and dispensed by a registered pharmacist; (2) furnished by a licensed physician, dentist, or podiatrist to patients; (3) furnished by a health facility to patients pursuant to the order of a licensed physician; (4) sold to a licensed physician or health facility for treating human beings; (5) sold to the state or other political subdivision for use in treating human beings; and (6) furnished without charge by a pharmaceutical manufacturer or distributor to a licensed physician, health facility, or institution of higher learning for research which will be used to treat human beings. In addition to medicines, qualifying items include such medical products as prosthetic and orthotic devices, hemodialysis products, insulin syringes, sutures, bone screws, and artificial limbs and eyes.

RATIONALE

This program provides tax relief to consumers of certain medicines and medical-related products. The underlying rationale for the program is that the price of medicines should not be increased by taxation because proper medical care and treatment is a basic necessity.

SPECIFIED MEDICAL-RELATED PRODUCTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6369.1, 6369.2, and 6369.5.

	Estimated Revenue Reduction	
(In Millions)		
	Fiscal Year	Amount
	1996-97	NA
	1997-98	NA
	1998-99	NA

DESCRIPTION

This program exempts from taxation the sale and use of the following medical-related products for personal use as directed by a physician: (1) wheelchairs, crutches, canes (including white canes for the blind), and walkers (including their replacement parts); (2) medical oxygen delivery systems; (3) hemodialysis equipment supplied by prescription; and (4) containers used to collect or store human blood.

RATIONALE

This program provides tax relief to consumers of specified medical-related products. The underlying rationale for the program is that such products are items of necessity to indi-

viduals who purchase them, and that their cost, therefore, should not be increased by taxation.

COMMENTS

Qualifying "medical oxygen delivery systems" include, but are not limited to, liquid oxygen containers, high pressure cylinders and regulators, when sold, leased, or rented to an individual for personal use under the direction of a physician. This program raises certain issues relating to tax equity and consistent tax-law treatment, since items such as corrective eyewear and auditory devices are *not* exempt from taxation, yet are used to treat medical conditions.

MEDICAL IDENTIFICATION TAGS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6371.

Estimated Revenue Reduction	
(In Millions)	
Amount	
Minor	
Minor	
Minor	

DESCRIPTION

This program exempts from taxation the transfer of medical identification tags furnished by a qualified nonprofit organization. The term "medical identification tags" includes any tag worn by a person for the purpose of identifying the wearer as having a medical disability or allergic reaction to certain medical treatments.

RATIONALE

This program provides tax relief to individuals who need to wear medical information tags because of health-related problems. The rationale for the program is that the prices of such tags should not be increased by taxation,

because the tags are a necessity for many individuals with serious health problems.

COMMENTS

This program was originally sponsored by the Medic Alert Foundation, a charitable nonprofit corporation engaged in gathering, storing, and furnishing information regarding the medical problems of members. When an individual subscribes to the Medic Alert Foundation, he or she has the option of purchasing either a bracelet or a necklace on which relevant medical emergency information is engraved. Such products also are available from various other similar types of organizations.

SPECIFIED MEDICAL HEALTH INFORMATION

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6408.

Estimated Revenue Reduction (In Millions)	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the use of medical health information literature purchased by qualified organizations. Such qualifying organizations must be formed and operated for charitable purposes, be eligible for the welfare exemption (a local property tax exemption available to nonprofit, charitable organizations), and be engaged in the dissemination of medical health information. In addition, the purchase of qualified literature must be made from the organization's national office or another branch of the national office of the same organization. The original purchase of these materials, from a printer for example, is not covered by the exemption.

RATIONALE

This program provides tax relief for organizations providing educational health information, and thereby enables these organizations to use their limited resources more effectively for educational purposes. The underlying rationale for the program is that the dissemination of medical health information is socially beneficial.

COMMENTS

The original proponent of this program was the American Heart Association. Prior to the inception of this program, sales and use taxes were levied on the medical information that the association distributed to its regional and local chapter affiliates.

HEALTH AND SAFETY INSIGNIA AND EDUCATIONAL MATERIALS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6409.

Estimated Revenue Reduction (In Millions)	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of health and safety insignia and educational materials routinely sold in connection with health, safety, and first aid classes. The program requires the insignia and materials to be sold or purchased by a national charitable organization which qualifies for the welfare exemption (a local property tax exemption available to nonprofit, charitable organizations). In addition, the materials must be purchased from the organization's national office or another branch or chapter of the national office of that organiza-

tion.

RATIONALE

This program offers tax relief to organizations providing specified health-related and safety-related materials and educational information, and for individuals who might purchase them. Thus, the program encourages the wider dissemination of these materials and information. The rationale for the program is that such materials and information are so-cially beneficial and worthy of public financial support.

FOOD ANIMAL MEDICINES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6358 (e).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$2
1997-98	4
1998-99	4

DESCRIPTION

This program exempts from taxation the sale or use of drugs or medicines for which the primary purpose is the prevention and/or control of disease in animal life that ordinarily constitutes food for human consumption.

RATIONALE

This program provides tax relief to consumers of medical products used on animal life that is used to produce animal food products consumed by humans. This follows the general rationale that food products are a basic necessity of life, and their prices should not be increased by taxation.

MEDICATED FEED AND DRINKING WATER

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code

Section 6358.4.

(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

Estimated Revenue Reduction

DESCRIPTION

This program exempts from taxation the gross receipts from the sale, storage, consumption, or use of drugs or medicines administered to animal life as an additive to feed or drinking water. The primary purpose of the additive must be prevention and control of disease in food animals or nonfood animals which are sold in the regular course of business.

RATIONALE

This program provides two types of tax relief. In the case of food animals, it provides tax relief to consumers of animal-based food products. This may be viewed as an extension of the general sales tax exemption for food products, which is based on the rationale that food is a basic necessity of human life and its price should not be increased by taxation.

The rationale for providing an exemption for medicines and drugs used to treat *non*food animals is that the cost of such treatment is incorporated in the price of these animals, which *is* subject to taxation. Thus, it is argued, taxing it separately would result in double taxation.

PRINTERS' AIDS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6010.3.

Estimated Revenue Reduction (In Millions)	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the fabrication or transfer of composed type or reproduction proofs, which are made by a typographer for the preparation of printed matter. In addition, this program exempts from taxation the fabrication of reproduction proofs or impressed mats when the materials are transferred to a printer or publisher for use in printing.

RATIONALE

This program provides tax relief to the printing industry assuming sales and use taxes on transfers of qualified printers' aids normally would be borne by printers. Traditionally, printers' aids often became the property of the customer, so that they were subject to sales

tax. These intermediate products of the printing process, however, were used to make final printing materials, which also were taxed upon their sale. This program thus reduces the degree of this sales tax "pyramiding" for the printing industry. It also tends to equalize tax treatment for printers' aids, regardless of the specific arrangements made regarding the transfer of printers' aids.

COMMENTS

Many other industries are subject to tax pyramiding, but the printing industry has argued that it was particularly hard hit by the multiple application of the sales and use tax. Newer computerized printing and publishing methods produce few, if any, intermediate printer's aids, so that the revenue loss from this program should decrease over time.

PARTNERSHIP PROPERTY USED TO PRODUCE MOTION PICTURES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6010.4.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the use of property rented, leased, or otherwise furnished by a partnership to its members for the production of motion pictures under certain circumstances. In order to qualify for the program, the partnership must be formed by parties engaged in the production or distribution of motion pictures in order to reduce production costs, by sharing equipment, studio facilities, and personnel. The exemption does not apply, however, if the partnership transfers title of any property to its members. In addition, the program does not exempt from taxation the original purchase of property by the partnership.

RATIONALE

This program provides benefits to some segments of the motion picture industry by reducing the costs they incur for using shared movie-making equipment and fabrication labor. It is rationalized on the grounds that it tends to equalize the taxation of equipment and fabrication labor provided "in-house" (say, in a vertically integrated movie company) with the taxation of these items when several studios or independent producers share these resources. The program thus removes a tax advantage that otherwise would benefit integrated studios (firms which are involved in the full range of movie-making activities) versus other motion picture producers.

COMMENTS

The basic structure of the sales and use tax inherently benefits businesses that are vertically integrated. This is because intracompany transfers of equipment and supplies are not considered a sale and, thus, are not taxed. This program extends an equivalent benefit to nonvertically integrated operations in this particular industry.

Newspapers and Periodicals, Distributed Free of Charge or by Subscription

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Sections 6362.3, 6362.7, and 6362.8.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$68
1997-98	72
1998-99	74

DESCRIPTION

This program exempts from taxation the sale or use of certain newspapers, periodicals, and any tangible personal property that becomes an ingredient or component of them. The exemption is available provided that a newspaper or periodical is regularly published (at least four times a year). In addition, the item must be: (1) distributed free of charge; or (2) sold by subscription and delivered by mail or common carrier; or (3) purchased or published by an organization that qualifies for tax-exempt status under Internal Revenue Code Section 501(c)(3) and meets certain other requirements. The exemption also applies to any newspaper or periodical that is sold by subscription pursuant to an agreement entered into and for which prepayment was received prior to July 15, 1991.

The term "periodical" is defined as meeting certain stated publication intervals during a year, with each issue bearing some relation to the previous issues. It does not include printed sales messages, shopping guides, or publications where advertising exceeds 90 percent of the printed area of an issue in

more than one-half the issues published in a 12-month period.

RATIONALE

This program provides tax relief to the publishers of qualified newspapers and periodicals, and to the consumers of these items. Proponents of this program contend that the contents of a newspaper or periodical are akin to an information service and, thus, the transfer of a newspaper or periodical is equivalent to the sale of a service. Because the transfer of services is generally exempt from sales and use taxation, these proponents thus argue that the transfer of other newspapers and periodicals also should be exempt.

COMMENTS

Generally, paid newspaper subscriptions are subject to taxation, since the publishers of such newspapers have "nexus," or sufficient economic presence in California for tax purposes. Some newspapers published out-of-state, however, have insufficient presence in California to trigger the levying of the sales and use tax.

LEASES OF MOTION PICTURES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6006 (g)(1) and 6010 (e)(1).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$29
1997-98	31
1998-99	32

DESCRIPTION

This program exempts from taxation the qualified lease or rental of motion pictures (including animated motion pictures), television films, and tapes (except video rentals for private use).

RATIONALE

This program provides tax relief to the owners and users of motion pictures and television shows. The apparent rationale for the program is to encourage expansion of the market for motion pictures and tapes in California by reducing the cost of leasing such pictures, and thereby promoting the economic health of the motion picture industry. Proponents of the exemption also argue that it is needed to provide tax equity between exhibitors of motion pictures and tapes versus other forms of entertainment, such as live

theater, that are *not* subject to the sales and use tax. There are, however, many forms of entertainment which *are* subject to sales and use taxes, such as videocassette rentals, books, and games.

COMMENTS

The estimated revenue reduction amounts shown above are based only on leases to movie theaters in California, because these transactions involve the transfer of a physical copy of the movie. Television programming, on the other hand, can be and often is transferred via satellite or phone lines. Thus it would *not* be subject to taxation, even in the absence of this program. Consequently, the additional revenues that would be realized from taxing leases of television programming would be relatively small.

MASTER TAPES AND MASTER RECORDS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6362.5.

Estimated Revenue Reduction (In Millions)	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation qualifying transfers of master tapes and master records that are used by the recording industry in making sound recordings. The sales tax *does* apply, however, to purchases of the tangible elements of such master tapes and recordings (for example, the cost of the blank tape) when these are acquired from a recording studio by a tape or recording producer.

RATIONALE

This program provides tax relief to the consumers of master tapes and records by reducing the prices of these items. At the time this program was enacted, it was rationalized on the basis that the value of a master tape or record was primarily attributable to the *intangible* element of the music or other informa-

tion stored on the tangible medium. The proponents of this exemption argued that it was not proper for the state to tax the value of such intangible elements.

COMMENTS

In 1988, the California Court of Appeals held that in certain circumstances the sale or lease of master tapes and records are *not* exempt from taxation. Specifically, in *A&M Records, Inc. v. State Board of Equalization* (1988 [204 Cal. App. 3d 358]), the court determined that the contract to purchase master tapes or records used for producing additional master recordings or copies *was* a taxable transaction. The court held, in this case, that the true object of the contract was for the production of such duplicates and not for the services of the artist.

PRINTED ADVERTISING MATERIALS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6379.5.

Estimated Revenue Reduction	
Amount	
NA	
NA	
NA	

DESCRIPTION

This program exempts from taxation the sale or use of catalogs, letters, circulars, brochures, and pamphlets consisting substantially of printed advertisements for goods and services. To qualify, these materials must be (1) printed to the special order of the purchaser and (2) mailed or delivered by the seller, seller's agent, or a mailing house through the United States Postal Service, or by common carrier to another person, at no cost to the recipient.

RATIONALE

This program provides tax relief to California printers and retailers. The rationale for the program is to provide tax equity for California printers. When a California retailer contracts with an out-of-state printer to print its advertising, the printing job is *not* subject to sales tax. In the absence of this program, a similar contract with a California printer *would* be subject to sales tax. Program proponents argue that the program is necessary to make California printers competitive with out-of-state printers.

COMMENTS

This program was established by Chapter 1515, Statutes of 1986 (SB 2527, Rob-

bins), and took effect on January 1, 1987. An alternative way to provide tax equity for California printers in the absence of this program would be to apply the use tax to printed advertising materials purchased from out-of-state printers by California firms. In cases where the out-of-state printer sends the advertising material directly to California recipients, there had been concern that imposing the use tax would unconstitutionally interfere with interstate commerce. That concern appears to have been erased by a 1988 decision of the U.S. Supreme Court (D.H. Holmes Co. v. McNamara, 48 U.S. 24, 100L Ed 2d 21, 108 S Ct 1619). In that case, the court unanimously upheld Louisiana's imposition of use tax on catalogs printed outside the state for a Louisiana retailer and delivered directly to prospective customers in Louisiana.

It is estimated that the total value of all catalog, directory, and printed advertising products generated for use in California is in the billions of dollars. If all such products were subject to taxation, the sales tax liabilities could be several hundred million dollars. However, this figure dramatically overstates the revenue loss to the state due to this program, for two reasons. First, an unknown number of these products are already subject to taxation. For example, catalogs that are

sold to consumers are taxed, as are many other advertising materials. Second, an unknown portion of these products would not be subject to taxation, even if this program were repealed. For example, according to the Board of Equalization, advertising inserts in many newspapers would continue to be exempt from taxation under the exemption for newspapers and periodicals.

MOTION PICTURES AND PRODUCTION SERVICES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6010.6.

enue Reduction
Amount
NA
NA
NA

DESCRIPTION

This program exempts from taxation charges for qualified production services (so-called "fabrication labor") used in the production of a motion picture (including videos, or any other commercial audiovisual works). These services include the production of special effects, animation, music, sound, editing, and photography, regardless of whether the service is performed under the producer's supervision or done independently. The exemption does not include the production of duplicate tapes for exhibition or broadcast, or release prints.

Additionally, the program exempts transfers of all or part of qualifying motion pictures, or any interest or rights to them (including partially finished work and intermediary materials). To qualify, the motion picture must either be (1) sold before it is first exhibited or broadcast to its general audience, or (2) transferred to any persons holding exploitation rights which they gained prior to the first exhibition.

These exemptions do not apply to (1) the transfer of raw film or videotape stock, (2) the transfer of release prints or tapes for exhibition or broadcast, or (3) rentals or leases of videocassettes, videotapes, or videodiscs for

private use. The term "qualified motion picture" does not include motion pictures produced for private noncommercial use, such as weddings or graduations.

RATIONALE

This program has several rationales. First, it provides an incentive for retaining motion picture production activities in California by reducing the industry's tax burden.

A second rationale is that the program simplifies tax administration. Before this program was established, the taxability of charges for special effects and other production services depended on whether these services were performed by studio employees or contractors supervised by the producer (in which case they were *not* taxable) versus by contractors operating independently (in which case they were taxable). Taxation was complex because it often was difficult to distinguish among the various contractual relationships involved.

A third program rationale is to create tax equity between studio employees and contractors who perform the *same* kinds of work, as well as tax equity between *integrated* producers that produce a *finished* work and those

that *specialize* in one *segment* of the work, such as filming or postproduction editing.

COMMENTS

Fabrication Labor. Although services themselves generally are not subject to the sales and use tax, fabrication labor used to make an item of tangible property generally is subject to tax. For example, charges by a tailor to make a suit are taxable even if the customer provides the cloth. This treatment provides tax equity between custom-made products and off-the-shelf products. However, there is no tax on fabrication labor if it is provided by employees of the same company that uses the finished product (since no sale or transfer of property occurs), or, in many cases, if the labor is performed under the supervision, and subject to the approval of the customer.

As regards the activities affected by this program, the creation of special effects for motion pictures usually involves the production of tangible property (a film or video product) that is an intermediary product used to incorporate the special effect into the final motion picture. In the absence of this program, the sale of that intermediate product to a producer by a contractor who is not supervised by that producer generally *would* be taxable.

Sales of Motion Pictures. Sales of completed motion pictures prior to their commercial exhibition are considered a sale for resale and would *not* be taxable, even in the absence of this program. In contrast, sales of rough footage or other intermediary products for a motion picture in progress generally *would* be taxable in the absence of this program.

MOBILE TRANSPORTATION EQUIPMENT LEASES

	Program Characteristics	Estimated Rev	venue Reduction
Tax Type:	Sales and Use Tax	(In Millions)	
Authorization:	California Revenue and Taxation Code	Fiscal Year	Amount
Authorization.	Sections 6006 (g)(4), 6010 (e)(4), and	1996-97	NA
	6023.	1997-98	NA
		1998-99	NA

DESCRIPTION

This program exempts from taxation the lease of certain mobile transportation equipment used in the transportation of persons or property. Qualifying equipment includes railroad cars and locomotives, buses, trucks, truck tractors, truck trailers, dollies, bogies, chassis, reusable cargo containers, aircraft, ships, and tangible personal property which is or becomes a component part of such equipment. Equipment which does not qualify for the program includes one-way rental vehicles, passenger vehicles, and trailers and baggage containers designed to be hauled by passenger vehicles. The purchase of mobile transportation equipment by the lessor, however, is generally subject to sales and use tax.

RATIONALE

This program provides tax relief to users of qualifying transportation equipment by reducing its price. According to the Board of Equalization, the program has several rationales. One involves the administrative complexities of determining the portion of leasing payments that is related to interstate commerce activities, which are exempt from taxation. Another relates to the difficulty of separating out the portion of lease payments associated with the provision of related services, such as maintenance, which are non-taxable.

COMMENTS

Existing law allows lessors of mobile transportation equipment to elect to pay tax on lease receipts, rather than on the equipment's cost at the time of purchase. However, this option is available only to lessors who make no use of the equipment other than renting or leasing it.

VESSELS THAT TRANSPORT OVER 1,000 TONS

Program Characteristics

Tax Type: Sales Tax.

Authorization: California Revenue and Taxation Code

Section 6356.

Estimated Reve	enue Reduction
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the *sales* tax the sale of certain vessels sold by their builder. In order for the program to apply, the vessel involved must be capable of transporting cargoes of more than 1,000 tons. The program does *not*, however, exempt such vessels from the *use* tax.

RATIONALE

The program was originally intended to eliminate a tax "penalty" for purchases of vessels within the state by equalizing their taxation with those purchased outside the state but used within it. At the time this program was enacted, it was thought that the purchase of a vessel from an out-of-state builder for use within the state could not be taxed by the State of California, due to limitations under

the U.S. Constitution involving state taxation of interstate commerce.

COMMENTS

The program's original rationale was super-seded by a 1942 federal court ruling involving the taxability of vessel purchases. Specifically, in the case of *Los Angeles Lumber Products v. State Board of Equalization* (45 Fed. Supp. 77), the court ruled that the U.S. Constitution does not prohibit a ship purchased out of state for in-state use from being taxed by California. Thus, the use tax applies to ships purchased out-of-state and used in California unless the operators qualify for other use tax exemptions (see program entitled "Qualified Watercraft and Their Component Parts.")

VEHICLES MODIFIED FOR PHYSICALLY HANDICAPPED PERSONS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6369.4.

Estimated Reve	enue Reduction
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale and use of items and materials used to modify vehicles for physically handicapped persons. In the event of the sale of such a vehicle to a qualified purchaser, the program also exempts from taxation the portion of the sales price of a vehicle attributable to handicapped modifications. In order to qualify, the vehicle purchaser must be eligible for a disabled license plate or placard for disabled parking.

RATIONALE

This program provides tax relief to physically handicapped persons who must rely on specially modified vehicles, such as those with wheelchair lifts and special steering devices. The underlying rationale for the program is that access to vehicles with special modifications is a necessity for many handicapped persons, and one that can impose financial burdens on them since their income-earning potential often is restricted.

New or Remanufactured Trucks and Trailers For Out-of-State Use

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6388 and 6388.5.

Estimated Reve	enue Reduction
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of new or remanufactured trucks, truck tractors, trailers, semitrailers, trailer coaches (any of which has an unladen weight equal to or exceeding 6,000 pounds), or auxiliary dollies purchased in California for use outside the state or in interstate or foreign commerce.

All of the above types of vehicles and equipment qualify for the tax exemption if the vehicle is: (1) purchased by an out-of-state resident from an out-of-state dealer, (2) delivered by the manufacturer to the purchaser within California, (3) taken out of the state within 30 days, and (4) registered in another state. These qualifications must be furnished in writing to the manufacturer or remanufacturer.

A somewhat broader exemption applies only to trailers and semitrailers. These vehicles may be purchased from either an in-state or out-of-state dealer, and they may be delivered by either the manufacturer, remanufacturer, or dealer within California. The exemption applies if they are (1) purchased for out-of-state use or for interstate or foreign commerce, (2) taken out of the state within a specified time period, and (3) regis-

tered in another state. If the trailer or semitrailer is manufactured out-of-state, the purchaser has 30 days to take it out of California. If the vehicle is manufactured in California, the purchaser has 75 days to remove it from the state. The purchaser does not have to be an out-of-state resident.

RATIONALE

This program benefits California manufacturers of trucks and trailers, and California dealers who sell trailers and semitrailers. In the absence of this program, purchases of qualifying equipment for out-of-state use from California manufacturers or from California dealers (for trailers and semitrailers) could be subject to the sales or use tax if delivery were to be taken at the manufacturer's or dealer's California location. Proponents argue that such a tax would discourage these purchases.

One rationale of the program is that it ensures that purchases for out-of-state use are not taxed. A second rationale for the program is that it stimulates the California trailer-coach manufacturing and remanufacturing industry.

COMMENTS

By making delivery outside California, the manufacturer or dealer could arrange to avoid any California sales or use tax liability on the transaction, even in the absence of this program. This is because the transaction would be classified as an interstate sale, which is not taxable. Given this, the actual revenue loss due to this exemption probably is relatively small. The primary effect of the program is to facilitate sales by California truck and trailer manufacturers and dealers, and to reduce their costs of delivering vehicles.

PROPERTY USED IN SPACE FLIGHTS

Program Characteristics		
Tax Type:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6380.	

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	\$7	
1997-98	8	
1998-99	12	

DESCRIPTION

This program exempts from taxation the sale or use of qualified property used in space flights originating in the state. Qualified property includes: (1) property that has space flight capabilities including orbital space facilities, satellites, and space vehicles; (2) property used aboard any space facility, vehicle, satellite, system, or station; and (3) fuel sold exclusively for space flight. This program still applies in the event of a failure, postponement, or cancellation of a launch of the qualified space property.

RATIONALE

This program provides a tax incentive for the use of facilities located in California as the

origin of space flights versus other similarly equipped facilities in other states. The program also conforms to general sales and use tax policy with respect to purchases of goods used exclusively outside of California.

COMMENTS

Pursuant to Chapter 323, Statutes of 1998 (AB 2798, Machado), this program was expanded to include equipment and property purchases related to *all* space flight activity in the state. Formerly, the program was applicable only to space flights originating at Vandenberg Air Force Base. The sunset date of January 1, 2004 was also eliminated through this legislation, extending the program indefinitely.

AIRCRAFT REPAIR AND RELATED EQUIPMENT

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Sections 6366 and 6366.1.

nue Reduction
Amount
\$11
16
16

DESCRIPTION

This program exempts from taxation the sale or use of tangible personal property purchased after October 1, 1996 that is used as a component part of specified commercial aircraft as a result of maintenance, repair, overhaul, or improvement. Qualifying aircraft must be used for business either as a common carrier or outside of California.

RATIONALE

This program allows California aircraft maintenance and repair businesses to reduce the prices at which their products are provided, thereby making this industry more competi-

tive with those in other states. This program also equalizes tax treatment for this industry with the railroad industry (which also has its own sales and use tax exemption for equipment used in maintaining or repairing railroads). This is important to the extent that the two industries compete as common carriers

COMMENTS

California is one of many states that has a sales and use tax exemption for aircraft repair equipment. The program thus prevents California from being placed at a competitive disadvantage with respect to airline hub activities.

RAILROAD AND RELATED EQUIPMENT

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6368.5 and 6411.

Estimated Reve	nue Reduction
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation the sale or use of tangible personal property used as a component part of qualified railroad equipment in the course of repairing, cleaning, altering, or improving that equipment outside of California. Qualifying railroad equipment includes locomotives and passenger cars and maintenance equipment used by or leased to a common carrier engaged in interstate or foreign commerce.

RATIONALE

This program allows California railroad maintenance and repair businesses to reduce the prices at which their products are provided, thereby making this industry more competitive with those in other states or countries. Because the equipment involved is installed in railroads engaged in interstate or foreign commerce, it often can be purchased in other states or countries. Exempting the

equipment from the California sales and use tax allows businesses to reduce the prices on the equipment sold, thus making it more competitive with other states or countries. This program also attempts to equalize tax treatment between the railroad industry and the airline industry (which also has a sales and use tax exemption for equipment used in maintaining or repairing aircraft). This would be important to the extent that the two industries compete as common carriers.

COMMENTS

Although this program makes an attempt at equalizing tax treatment for competing industries, the most direct competition with railroads in the transportation of goods across state lines is the trucking industry. Since the trucking industry does not benefit from a similar program, this program would appear to grant advantageous tax treatment to the railroad industry.

LEASES OF SPECIFIED LINENS

Program Characteristics	
Тах Туре:	Sales and Use Tax.
Authorization:	California Revenue and Taxation Code Sections 6006 (g) (2) and 6010 (e) (2).

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	\$40	
1997-98	42	
1998-99	44	

DESCRIPTION

This program exempts from taxation the sale and use of linen supplies and similar articles. To qualify for the program, these supplies and articles must be provided under a lease agreement that includes recurring laundering and cleaning services. Linens exempt under this program are taxable at the time of purchase by the lessor.

RATIONALE

This program gives tax relief to providers and consumers of leased linen. Its apparent ratio-

nale is that most of the price charged for linen supplies represents the cost of the laundering and cleaning services, which would be exempt if provided separately.

COMMENTS

Generally, lessors have the option of paying sales and use tax on their original purchase price or on their lease receipts. Consequently, this program allows taxation of leased linen on the basis of its original purchase price.

LEASES OF HOUSEHOLD FURNISHINGS

	Program Characteristics	Estimated R	evenue Reduction
Tax Type:	Sales and Use Tax	(In Millions)	
Authorization:	California Revenue and Taxation Code	Fiscal Year	Amount
Autnorization:	Sections 6006 (g) (3) and 6010 (e) (3).	1996-97	Minor
		1997-98	Minor
		1998-99	Minor

DESCRIPTION

This program exempts from taxation the lease of household furnishings, when the furnishings are leased along with a lease of the living quarters in which they are to be used. The furnishings are taxable, however, at the time of purchase by the lessor.

RATIONALE

According to the Board of Equalization, this program exists to facilitate tax administration. Taxing the rental of furnishings in living quarters would require registering and auditing landlords, who generally are not sellers of any other taxable goods. Also, it would be

difficult to determine what portion of the rent is for the furnishings.

COMMENTS

Generally, landlords pay tax when they purchase furniture, and would not be taxed on their furniture rental receipts, even in the absence of this program. This is because of the broader provision that allows lessors to choose whether to pay tax on their original purchase amount or on their lease or rental receipts. The program equalizes tax treatment between landlords that buy furniture to rent, versus furniture leased out by a rental company.

FACTORY-BUILT HOUSING

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6012.7.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation 60 percent of the sales price of qualified factory-built housing. "Factory-built" housing includes such types as modular housing and sectionalized housing. The program does *not* exempt: (1) mobile homes; (2) precut housing packages where more than 50 percent of the package consists of precut lumber only; (3) panelized construction (such as walls or components that may become one or more rooms of a building) that is not a complete housing package; and (4) porches or awnings not purchased with a complete housing package.

RATIONALE

This program attempts to equalize the sales and use tax treatment of factory-built housing with that of conventional housing. When a contractor builds a conventional fixed-foun-dation home, he or she normally pays sales and use taxes on the tangible property that becomes a part of the home, such as lumber, paint, and wallboard. The home sale itself, however, is *not* subject to the sales tax, since the tax is levied on tangible personal property only. Thus, only the value of the home due to the materials embodied in it, is subject to taxation.

This program applies a similar approach to taxing factory-built housing when sold by a manufacturer or dealer. Specifically, data from the industry indicate that about 40 percent of the sales price of modular housing represents the value of materials. Thus, this program excludes from taxation the remaining 60 percent of the sales price not due to materials.

COMMENTS

The Board of Equalization (BOE) Regulation 1521 generally treats the purchase and installation of modular buildings as *construction* contracts for sales and use tax purposes. Consequently, the manufacturer pays tax on materials, and the purchaser pays tax only on the value of fixtures (such as an air conditioner or stove). According to BOE, the total tax liability under this regulation is similar to the assumed tax liability under the sales and use tax. Therefore, while this program gives statutory weight to this type of treatment, it does not significantly affect tax revenues compared with BOE's regulatory interpretation of general sales and use tax law.

NEW MOBILEHOMES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6012.8 and 6012.9.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation 25 percent of the sales price of a new mobilehome charged by the manufacturer to the retailer, provided that the home is sold by the retailer for installation on a foundation for occupancy as a residence. (The sale of the mobilehome by the retailer to the homeowner is fully tax-exempt.)

RATIONALE

The rationale for the program is based on the belief that mobilehomes should be treated like conventional housing for tax purposes. This program provides a measure of tax equity between mobilehomes used on a permanent site versus conventional and factory-built housing. It does this by recognizing that a portion of the retail value of both conventional and factory-built housing is exempt from sales and use taxation. Specifically, in the case of qualified factory-built housing, the exemption is equal to 60 percent of the consumer's purchase price. In the case of conventional housing, the difference between a house's selling price and the cost of taxable materials to the builder is not subject to taxation.

USED MOBILEHOMES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6379.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$22
1997-98	23
1998-99	24

DESCRIPTION

This program exempts from taxation the sale or use of any used mobilehome that is subject to the property tax.

RATIONALE

This program provides tax relief to the seller of a used mobilehome and to its purchaser to the extent that the reduced tax liability is reflected in lower selling prices. The rationale for the program is to equalize treatment of mobilehomes with that of conventional housing, whose resales are not subject to sales and use taxation.

COMMENTS

Any new mobilehome used as a residence purchased after 1980 is automatically placed on the local property tax roll, and therefore would not be subject to sales tax upon resale.

However, for new mobilehomes purchased prior to 1980, the mobilehome owner may choose whether to treat the mobilehome as property subject to the property tax or as a vehicle. In the latter case, the owner would pay an annual licensing fee, and the buyer would be liable for sales and use tax upon resale of the mobilehome.

CUSTOM COMPUTER PROGRAMS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6010.9.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Yea	r Amount
1996-97	\$253
1997-98	266
1998-99	276

DESCRIPTION

This program exempts from taxation the sale of custom computer programs, other than a basic operational program (including a control program). In addition, a program's documentation manuals and storage media also are exempt from taxation.

RATIONALE

The rationale for this program is that sales of qualified custom computer programs are primarily service-type transactions and, therefore, not subject to taxation.

COMMENTS

This program was established in 1982 by Chapter 1274, Statutes of 1982 (AB 2932,

Vasconcellos). That measure stated it was the Legislature's finding and declaration that the sales of custom programs, other than basic operational programs, are service transactions *not* subject to any sales and use taxes. The measure further stated that the use of any storage media in the transfer of custom computer programs is only incidental to the true objective of the transaction, which is the performance of a service. As such, the Legislature declared that the measure was declaratory of, and not a change in, existing law.

The *resale* of a custom computer program *is* subject to tax, however, because the program was not prepared to the special order of the purchaser (*Touche Ross & Co., v. State Board of Equalization*, 203 Cal. App.3d 1057, review denied).

CALIFORNIA GOLD MEDALLIONS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6354.

Estimated Reve	Estimated Revenue Reduction	
(In Millions)		
Fiscal Year	Amount	
1996-97	Minor	
1997-98	Minor	
1998-99	Minor	

DESCRIPTION

This program exempts from taxation the sale or use of commemorative "California Gold" medallions.

RATIONALE

This program provides an incentive for individuals to purchase commemorative California Gold medallions, by lowering their price.

The program also equalizes the tax treatment of these medallions with that of monetized bullion, nonmonetized bullion, and certain coins and medallions which are exempt (in values of \$1,000 or more) under Section 6355 of the Revenue and Taxation Code. Proponents of this program argue that California Gold medallions are comparable to these

other items (such as South African Krugerrands), because all can be used as metallic stores of wealth and financial investments.

COMMENTS

This program gives California Gold medallions an advantage over bullion coins (see program entitled "Monetized Bullion, Gold and Silver Bullion, and Numismatic Coins") by exempting *all* of their sales, not just those for \$1,000 or more.

The Department of General Services was required by Chapter 826, Statutes of 1982 (AB 676, Kelley) to design a series of commemorative California gold medallions to which this program applies.

MONETIZED BULLION, GOLD AND SILVER BULLION, AND NUMISMATIC COINS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6355.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of monetized bullion (coins whose value is essentially the same as that of the metal they contain), nonmonetized gold and silver bullion, and numismatic coins (these have value beyond their metal content due to rarity or aesthetic appeal), including gold medallions struck under the authority of the American Arts Gold Medallion Act. To qualify for the program, individual transactions must have a market value of \$1,000 or more.

On or before September 1, 1994, and each year thereafter, the minimum market value used to qualify for the program is to be adjusted for inflation when the sum of the adjustments equals or exceeds \$500. The inflation-adjusted amount is to be rounded to the nearest \$500.

RATIONALE

This program provides tax relief to purchasers and sellers of qualifying coins and bullion.

The program is rationalized on two basic grounds. First, many buyers of coins or bul-

lion could avoid California sales tax by making purchases from dealers in other states, either in person or by mail. Although they would be liable for use tax on these purchases in the absence of this program, as a practical matter, the use tax is rarely collected on these types of transactions. Thus, program proponents argue that the actual revenue loss from this program is minor, and that the exemption promotes economic activity in California from coin and bullion sales, as well as enabling buyers to deal with local businesses.

Second, proponents argue that the program increases tax equity by equalizing tax treatment of coins and bullion with competing investment vehicles, such as stocks and real estate, which are not subject to the sales or use tax.

COMMENTS

We reviewed this program in detail in our *Report on the 1988-89 Tax Expenditure Budget* (Report 88-20, December 1988), pages 71-76. We concluded that, in the absence of this program, most larger sales of *bullion* (in either monetized or nonmonetized form) would shift to out-of-state dealers, and the state would collect relatively little additional revenue unless changes were made in federal

laws that make collection of taxes on these interstate transactions more feasible. However, we recommended repealing the exemption for *numismatic coins*, because this exemp-

tion clearly conflicts with the state's general policy of applying sales and use taxes to other collectibles, such as artworks and jewelry.

RETURNABLE CONTAINERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6364 (c).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of returnable containers, when sold with their contents, or when resold for refilling. A "returnable container" means a container that customarily may be returned by the buyer of the contents for reuse. All other containers are classified nonreturnable containers for the purpose of this program.

RATIONALE

This program provides tax relief to consumers of products sold in returnable containers

by reducing the price of such items. The program's rationale is that the "price" charged for a returnable container often is a deposit, and applying the sales tax on each transaction could result over time in cumulative total sales taxes that eventually might amount to more than the value of the container itself. Thus, the program removes a disincentive to the use of returnable containers, which are viewed as beneficial from a resource conservation and environmental perspective.

CONTAINERS WHOSE CONTENTS ARE TAX-EXEMPT

	Program Characteristics	Estimated R	evenue Reduction
Tax Type:	Sales and Use Tax	(In Millions)	
Authorization:	California Revenue and Taxation Code	Fiscal Year	Amount
Authorization.	Section 6364 (b).	1996-97	NA
	, ,	1997-98	NA
		1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of filled containers whose contents are not subject to the sales and use tax.

RATIONALE

This program provides tax relief to consumers of tax-exempt goods that are sold in containers (such as most food products). The program also benefits industries producing containerized packaging by encouraging its use. The main rationale for the program appears to be that it lowers the prices at which

food and other tax-exempt goods may be sold to consumers. It also simplifies tax administration by eliminating the need to separately state the container prices.

COMMENTS

This program provides an indirect subsidy to consumers who retain empty containers for subsequent use. Examples of this include the use of plastic milk cartons as water jugs, and plastic butter containers as kitchen food-storage bowls.

ORIGINAL ARTWORKS AND DISPLAYS FOR SPECIFIED MUSEUMS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6365 and 6366.4.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of original works of art which are purchased (1) by a qualified nonprofit organization, (2) by a state or local government entity, or (3) for donation to a qualified government entity or nonprofit organization. The exemption applies only to art purchased to become a permanent part of the collection of a qualified museum, local government entity, or nonprofit organization.

To qualify, a museum must either: (1) have a significant portion of its space open to the public without charge; (2) be open to the public without charge for not less than six hours per month during any month when the museum is open to the public; or (3) be open to a segment of the student or adult population without charge. For a local government entity to qualify, it must purchase or commission art for public display in buildings, parks, plazas, or other public areas. Such areas must be open to the public at least 20 hours per week for at least 35 weeks of the year. In the case of a nonprofit organization, there are a variety of additional qualifying requirements.

This program also exempts museum pieces purchased for or by the San Diego Aerospace

Museum or the California Science Center. The exemption applies only to items which have value as museum pieces. It does not cover display cases, shelving, lamps, or other property used in operation of the museum.

RATIONALE

This program provides an incentive for individuals or organizations to donate, and for government agencies and nonprofit organizations to acquire, works of art that will be made available to the public to enjoy. It does this to the extent that sales and use taxes on artwork ordinarily would increase the cost of acquiring it. The program's underlying rationale is that art and the displays provided by qualified organizations provide valuable cultural and educational benefits which are worthy of public financial support.

COMMENTS

Separate provisions were established to cover the San Diego Aerospace Museum and the California Science Center, because some of their museum pieces would not necessarily be called "works of art," and thus would not qualify under the artwork exemption. These separate provisions extend the exemption to all of the museum pieces of these two facilities.

SINGLE-USE MAILING LISTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6379.8.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts mailing lists from the sales and use tax where names and addresses or other information are recorded on magnetic tapes or similar devices, and the contract regarding the mailing list restricts the purchaser to a single use.

RATIONALE

This program provides tax relief to individuals and institutions who have one-time access

to mailing lists. The program is rationalized on administrative grounds, on the basis that the taxes collected from the one-time use of such mailing lists would likely be exceeded by the administrative costs of collection.

COMMENTS

This exemption would typically not apply to corporations who conduct mail-order campaigns, since such activity requires the reuse of mailing lists.

SALE-LEASEBACKS INVOLVING CERTAIN GOVERNMENTAL ENTITIES

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Sections 6010.10, 6010.11, 6018.8, and 6368.7.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of certain transportation, pollution control, or alternative energy equipment when these transfers constitute sale-lease-backs or similar arrangements with designated public agencies for financing purposes. The *initial* purchase of the equipment is *not* exempt from sales or use tax, however. In order to qualify, the equipment transfer must fall into one of the following categories:

- Transfers of project property to the California Alternative Energy and Advanced Transportation Source Financing Authority, and leases by the authority back to project-participating parties.
- Transfers of pollution control equipment and facilities to the California Pollution Control Financing Authority, and leases by the authority back to project-participating parties.
- Transfers or leases of mass commuting vehicles (such as buses and rail transit cars) between transit operators and parties providing financing un-

der a "safe harbor" lease arrangement under federal tax laws.

Transfers of commuter vehicles (including railcars and locomotives, bus and van fleets, and ferryboats) by the California Department of Transportation (Caltrans), and leases of these vehicles back to the department under sale-leaseback arrangements authorized by California Government Code Section 14060 et seq.

RATIONALE

This program provides tax relief to purchasers of alternative energy and pollution control equipment which receive financing assistance from state revenue bond authorities. The program also provides tax relief to transit agencies and Caltrans for transit and commuter vehicles financed through qualifying sale-leaseback arrangements.

The program has two rationales. First, it is argued that alternative energy, pollution control, and transit programs are beneficial to society and, therefore, merit public financial support. The second rationale offered by program supporters is that, because the exempt transactions are not authentic sales or

leases but merely "paper" transactions to obtain favorable financing terms, they should not be taxed.

COMMENTS

This program predates enactment of Chapter 558, Statutes of 1990 (AB 3382, Baker), which provides a general exemption from sales and use taxes for property transfers made under qualifying acquisition sale-leaseback arrangements. In the absence of the special programs

discussed in this review, many of its specifically exempted transactions probably would qualify for this general exemption (or could be structured to do so). In addition, some transactions exempted under the program might not be deemed by the courts to be taxable sales or leases, even in the absence of both the special and general sale-leaseback exemptions, under the precedent established by *Cedars-Sinai Medical Center v. State Board of Equalization* (162 Cal. App.3d 1182).

MOTOR VEHICLE FUEL USED IN AIRPLANES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6357.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of qualified motor vehicle fuel used to propel aircraft. (This exemption does not apply to aircraft jet fuel.) To qualify, the fuel must be subject to the motor vehicle fuel tax and not be subject to refund.

RATIONALE

This program provides tax relief to owners and users of certain aircraft. The rationale for the program relates to the reason why motor vehicle fuel became subject to the sales and use tax in 1972. Prior to that time, such fuel was subject only to motor vehicle fuel *excise* taxes. In 1972, however, fuel also became subject to sales and use taxation, a portion of which is levied as a means of raising revenues for transportation-related purposes, including support of highways and mass transit. Because air transportation does not

benefit from the use of these revenues, motor vehicle fuel used in airplanes remained exempt from sales and use taxation.

COMMENTS

Motor vehicle fuel is subject to full state and local sales and use taxation, a portion of the revenues from which is dedicated to transportation-related purposes. The remaining portion is largely channeled into the state's General Fund for general purposes. The rationale for not taxing motor vehicle fuel for airplane use would not apply to the General Fund portion of the sales and use tax. This portion is exempt for reasons of administrative convenience and simplicity.

Jet aircraft fuel is not subject to the motor vehicle fuel tax. Rather, it is subject to a special aircraft jet fuel tax of 2 cents per gallon.

FUEL SOLD TO AIR COMMON CARRIERS FOR INTERNATIONAL FLIGHTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6357.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$19
1997-98	20
1998-99	20

DESCRIPTION

This program exempts from taxation the sale and use of fuel and petroleum products used by air common carriers for immediate consumption on an international flight. An international flight is defined as a flight whose final destination is a point outside of the United States.

Any fuel sold to a common carrier for use outside the state *after* the first out-of-state destination is exempt from taxation regardless of this program, so that the net effect of this program is to exempt fuel used on the "first leg" of an international flight.

RATIONALE

This program benefits domestic producers of jet fuel, and airlines that have international flights originating in California. It does so by reducing the price of fuel purchased in California for these flights. The program is rationalized on the basis that it equalizes the tax treatment of domestic fuel producers with that of foreign fuel producers. Current federal law prohibits states from taxing imported

fuel brought into the state under customs bond and transferred to common carriers for use in foreign commerce. By applying a similar exemption to domestically produced fuel, the program reduces the relative costs of using domestic fuel on flights, making it more competitive with foreign fuel.

COMMENTS

This program was added by Chapter 1227, Statutes of 1988 (SB 1942, Craven), and became operative January 1, 1989, contingent on federal exemption provided in Section 1309 of Title 19 of the United States Code. If the federal prohibition on taxing foreign fuel used in foreign commerce is repealed, this program will also be repealed at the same time.

Opponents of this program argue that, while the federal prohibition on taxing foreign fuel does place domestic fuel producers at a competitive disadvantage, the problem should not be addressed by a California state tax exemption on domestic fuel. Instead, efforts should be made to have the federal prohibition on taxing foreign fuel repealed.

FUEL USED IN WATER COMMON CARRIERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6385 (c).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	\$16
1997-98	17
1998-99	18

DESCRIPTION

This program exempts from taxation the sale and use of fuel and petroleum products used by a water common carrier (such as a cruise ship or cargo freighter) after it has reached its first out-of-state destination at which passengers or cargo are loaded or discharged. The taxpayer is required to furnish the seller of fuel or petroleum products an exemption certificate in writing, specifying the quantity of fuel or petroleum products exempt from sales and use taxation. This program sunsets on January 1, 2003.

RATIONALE

This program benefits domestic producers of fuel and petroleum products sold to water common carriers and interstate water common carriers. It does so by reducing the price of fuel purchased in California for these carriers. The program is rationalized on the basis that the fuel purchased is being used outside of California. Thus, it equalizes its tax treatment with that of other goods purchased in the state solely for use outside of California. In addition, a portion of the sales tax is meant to raise revenues for transportation-related purposes, including highways and mass transit. Because water common carriers do not benefit from the use of these revenues, it can be rationalized that it should not be subject to at least this portion of the sales and use tax.

MEALS AND FOOD PRODUCTS SERVED IN SCHOOLS

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization:	California Revenue and Taxation Code Section 6363.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of qualified meals and food products that are furnished or served to students in schools (including colleges and universities). In order to qualify for the program, the food must be provided by a public or private school, a school district, a student organization, a parent-teacher organization, or certain blind persons.

RATIONALE

This program provides tax relief to students who consume meals and food products provided by qualified persons and organizations to the extent that taxes levied on such meals and food products ordinarily would increase their prices. The program's rationale is that proper student nutrition should be encouraged and, therefore, the price of the food should not be increased by taxation. The program is also justified on the grounds that students may not have access to cooking facilities, and this type of meal service may be the only option for such individuals.

HOT FOOD PRODUCTS SERVED TO AIRPLANE PASSENGERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6359.1.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of hot prepared food which is either (1) sold by caterers and other vendors to airlines for consumption by passengers, or (2) sold or served to passengers by airlines. The program applies to air carriers engaged in interstate or foreign commerce.

RATIONALE

This program simplifies tax administration by eliminating the need to allocate meals by state on interstate flights between California and other states. The program also provides tax relief to the consumers of food on airplanes. The program's proponents have argued that the exemption is appropriate because providing food service is incidental to an airline's main service, which is to provide air transportation.

According to this argument, air travelers are "captive eaters," having no choice as to whether food products will be made available to them. Accordingly, the cost of the meal is incorporated in the price of the ticket whether or not they choose to consume the food provided. Thus, it is argued that such meals should not be subject to taxation.

MEALS SERVED TO PATIENTS AND RESIDENTS OF HEALTH CARE FACILITIES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6363.6.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of meals and food products which are served to patients or residents of any of the following (under certain conditions): (1) a health facility, (2) a community care facility, (3) a residential care facility for the elderly, (4) alcohol or drug abuse treatment facilities, or (5) a house or institution providing room and board for the elderly.

RATIONALE

This program provides tax relief to consumers of meals and food products served at qualified

health care facilities, to the extent that sales and use taxes levied on such products ordinarily would be incorporated into the prices charged for them. The underlying rationales for the program are that (1) pro-viding proper nutrition for residents of health care facilities should be encouraged and, therefore, the price of food in such facilities should not be increased by taxation, and (2) residents of these facilities generally do not have the alternative of cooking for themselves.

MEALS PROVIDED TO QUALIFIED LOW-INCOME SENIOR CITIZENS

Program Characteristics		
Tax Type:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6374.	

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of meals and food products served to low-income elderly persons by a nonprofit organization or governmental agency under a program funded by the state or the U.S. government. To qualify for the program, a meal must be sold at, or below, cost.

RATIONALE

This program provides tax relief to low-income senior citizens who consume

qualified meals. The underlying rationale for the program is that providing proper nutrition to low-income senior citizens should be encouraged and, therefore, the price of food served to qualifying individuals should not be increased by taxation.

COMMENTS

Many meal programs for low-income elderly persons do not charge for the meals, and those meals would not be subject to tax even in the absence of this program.

MEALS DELIVERED TO ELDERLY AND DISABLED INDIVIDUALS

Program Characteristics	
Тах Туре:	Sales and Use Tax.
Authorization:	California Revenue and Taxation Code Section 6363.7.
	Section 6363.7.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation the gross receipts from the sale, storage, use, or consumption of meals that are delivered to homebound elderly or disabled persons by a nonprofit volunteer home-delivery meal provider (such as "Meals on Wheels").

RATIONALE

This program provides tax relief to those individuals that must rely on such services for their meals. Such services provide the proper nutrition to individuals who might otherwise not be able to prepare similar meals for themselves because of their limited mobility. It also encourages nonprofit organizations that may provide such meals at reduced prices to continue doing so.

MEALS PREPARED IN COMMON KITCHEN FACILITIES FOR QUALIFIED SENIOR CITIZENS

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization:	California Revenue and Taxation Code Section 6376.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from sales and use taxation meals or food products furnished to and consumed by qualified persons 62 years of age or older. The program applies, for example, to food consumed by senior citizens who reside in a condominium and own equal shares in a common kitchen, and for whom food is served on a regular basis.

RATIONALE

The program provides tax relief to senior citizens living in housing that supplies room and board. The program also equalizes the tax treatment of food served to senior citizens living in independent settings with that of persons living in health care facilities. The underlying rationale for the program is that providing proper nutrition to senior citizens should be encouraged and, therefore, the price of the food served to qualifying individuals should not be increased by taxation.

MEALS AND FOOD PRODUCTS SERVED BY RELIGIOUS ORGANIZATIONS

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Section 6363.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation qualified meals and food products that are served by a religious organization, or under its auspices. To qualify, the revenue obtained from serving the meal or food must be used in carrying on the functions and activities of the organization. In addition, only those organizations which qualify for the religious property tax exemption may qualify for this program.

RATIONALE

This program provides tax relief for needy persons who are provided meals at nominal costs by religious organizations. Because the program reduces the price and/or cost of

providing a meal to a needy person, the program also encourages qualified organizations to provide such meals. The underlying rationale for this aspect of the program is that providing meals to needy persons is a socially beneficial activity.

COMMENTS

A "qualified" religious organization is defined as one which is exempt from property taxes under Article XIII, Section 3(f) of the California State Constitution. This property tax exemption applies to buildings, land on which they are situated, and equipment, provided they are used exclusively for religious worship.

FOOD STAMP PURCHASES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6373.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation all purchases made with food stamps. When both food stamps and cash are used to purchase goods, the amount of the food stamps is applied to the cost of taxable items first.

RATIONALE

California enacted this program to comply with the Federal Food Security Act of 1985, which prohibits any state from participating in the Food Stamp Program if that state taxes food stamp purchases.

California generally exempts food products from the sales and use tax, but some food purchases allowed under the food stamp program are not covered under California's general food exemption (such as carbonated sodas). Thus, a separate provision was needed to exempt such items when purchased with food stamps.

COMMENTS

This program will be repealed automatically if and when the federal government passes legislation which repeals the prohibition on state sales taxation of food stamp purchases.

HEALTH CARE PROFESSIONALS TREATED AS CONSUMERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6018, 6018.4, 6018.5, 6018.7,

and 6020.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program provides a partial tax exemption for qualified health care items by treating various licensed health care professionals as if they were the consumer (rather than the retailer) of items that they provide to their patients and clients as part of their professional services. As such, tax is paid on the price that these professionals *pay*, rather than the price that they *charge*, for these items. Because the latter price typically is greater than the former price, less tax is paid. The program applies to the following professions and items:

- Optometrists, physicians, surgeons, and dispensing opticians with respect to ophthalmic materials, including eyeglasses and contact lenses.
- Chiropractors, with respect to vitamins, minerals, dietary supplements, and orthotic devices.
- Podiatrists, with respect to prosthetic materials and inlays, including archsupports and special footgear.
- Hearing aid dispensers, with respect to hearing aids.

X-ray providers, with respect to materials and supplies for medical and dental x-rays, except for purely cosmetic purposes.

RATIONALE

This program provides tax relief to persons who purchase qualified items from health care professionals. This relief occurs to the extent that sales and use taxes levied on the full retail value of such products (versus their cost to health care professionals) ordinarily would increase their prices. The program's rationale is that these products are a component of good health care, which is a basic necessity, and therefore, their prices should not be subject to full taxation.

COMMENTS

This program and others like it, which define the providers of goods as consumers, result in the partial exemption of such products from taxation. The amount of the exemption is tied to the value added to the product's retail price by the provider. The basic cost of the product to the provider, however, *is* subject to sales and use taxation.

VETERINARIANS TREATED AS CONSUMERS

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Section 6018.1. Estin (In Mill) Fisca 1996

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program treats a licensed veterinarian as a consumer (as opposed to as a retailer) of the drugs and medicines used or furnished in the performance of his or her professional services. As a consequence, the program partially exempts the retail value of such items from taxation.

RATIONALE

This program provides tax relief to the clientele of veterinarians. The amount of the tax relief relates to the difference between the price of such items to consumers and the cost of such items to veterinarians. The underlying rationale for the program is that medicines and drugs prescribed for animals are a necessity for these creatures and therefore,

the price of the medicines should not be subject to full taxation.

COMMENTS

The term "drugs and medicines" includes substances necessary for the diagnosis, cure, mitigation, treatment, or prevention of animal diseases. It excludes such items as shampoos, pet foods, flea powders and sprays, and vitamins. The largest uses of veterinary drugs are totally exempt from taxation, however. This is because the Board of Equalization's Sales Tax Regulation 1587 (2) (b) and (c) includes medicated feeds and drugs purchased to formulate medicated feeds under the general exemption for animal feeds. Consequently, the revenue loss from this program, though unknown, is probably relatively small.

AIRCRAFT FOR COMMON CARRIERS OR FOR USE BY FOREIGN GOVERNMENTS OR NONRESIDENTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6366 and 6366.1.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of aircraft which are to be used either as common carriers or outside of California. The program also exempts from taxation tangible personal property sold to an aircraft manufacturer and incorporated into such aircraft.

In order for aircraft or tangible personal property to qualify for the exemption, the operator's annual gross receipts from common carrier operations must either (1) exceed the lesser of 20 percent of the purchase cost of the aircraft or \$50,000 or (2) the operator must provide evidence that the property is used for common carrier purposes. For leased property, the comparable limits are 10 percent and \$25,000.

RATIONALE

This program reduces the prices at which the California airplane industry sells airplanes, thereby making the industry more competitive.

COMMENTS

Although billions of dollars of sales are exempted from taxation under this program, little of that forgone tax liability would be realized in the program's absence. This is because aircraft sold to common carriers easily could be delivered to them outside of California. In that case, the transaction would be an interstate or international sale that is not subject to California taxation. There would be a compelling incentive to arrange such out-of-state purchase in most cases because the amount of tax avoided could be several million dollars on a modern commercial jetliner.

TRAILERS AND SEMITRAILERS MOVED TO PLACE OF SALE

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6410, and California Vehicle Code

Section 4003.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the use, storage, or other consumption in California of new or used semitrailers that (1) are not currently registered in any state and (2) are operated in the state for not more than five days as part of a continuous trip to a place where the vehicle will be offered for sale. To qualify for the exemption, the trailer or semitrailer must have obtained a one-trip permit issued by the California Department of Motor Vehicles. Under normal conditions, a use tax would be levied on the use of the vehicle for transporting goods in-state.

RATIONALE

This program provides tax relief to the operators of trailers and semitrailers operating under a one-trip permit. When this program first was established in 1986, the proponents offered the rationale that operators should not be charged, in essence, twice for their use of roads. Their view was that double-charging would occur in the absence of the program because operators of laden trailers would be required to pay for both (1) a one-trip permit and (2) use taxes based on the rental or sale value of the trailer.

Another suggested rationale for this program is that it simplifies tax administration, by

relieving tax authorities from locating and assessing use taxes on one-trip operators.

COMMENTS

Neither of the two rationales supporting this program is entirely satisfactory. Regarding the double taxation rationale, it fails to recognize that the use tax and the one-trip permit fee are for two separate purposes. In the case of the rationale relating to administrative simplicity, its significance is limited because use taxes could be assessed at the same time operators are issued their one-trip permits.

Despite the weaknesses of the rationales, even if the Legislature chose to eliminate this program, the state probably would realize relatively little revenue gain. This is because simply moving an empty trailer to a place of sale would not constitute a use that would be subject to tax. The effect of this program is to make it economically feasible for these trailers to carry freight when they are moved to a place of sale. In many cases, the earnings from this freight carriage would be less than the use tax, and trailer owners would therefore simply move their vehicles unladen (thus generating no tax liability) if the exemption were not available.

QUALIFIED WATERCRAFT AND THEIR COMPONENT PARTS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6368 and 6368.1.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from sales and use taxation the sale, lease, or rental of a qualified watercraft and its component parts (including parts used in repairing or maintaining the vessel). In order to qualify for the program, the craft must either be (1) used in interstate or foreign commerce for the transportation of property or persons for hire, (2) used for commercial deep sea fishing operations outside of California's territorial waters, or (3) used 80 percent or more of the time in transporting for hire property or persons to vessels or offshore drilling platforms located outside of California's territorial waters.

In order for a vessel to qualify as a commercial deep sea fishing vessel, the operator's

gross receipts from commercial fishing operations must be at least \$20,000 per year, or the operator must provide evidence that the vessel is used for commercial deep sea fishing. In order to qualify as a watercraft used in interstate or foreign commerce, the operator's gross receipts must (1) exceed either 10 percent of the cost of the watercraft or \$25,000 or (2) provide evidence that the vessel is used for qualifying commercial purposes.

RATIONALE

This program allows California watercraft builders and dealers, and vessel maintenance and repair businesses to reduce the prices at which their products may be provided, thereby making the California industry more competitive.

VEHICLES, VESSELS, AND AIRCRAFT TRANSFERRED WITHIN A FAMILY

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6285.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the transfer of vehicles, vessels, and aircraft when the property is sold by the purchaser's parent, grandparent, child, grandchild, spouse, or brother or sister, (if both are minors).

The exemption also applies when the sale is to a trust in which: (1) the seller has an unrestricted power to revoke the trust; (2) the sale does not result in any change in the beneficial ownership of the property; (3) the trust provides that, upon its revocation, the property will revert wholly to the seller; and (4) the only consideration for the sale is the assumption by the trust of an existing loan for which

the tangible personal property being transferred is the sole collateral.

RATIONALE

This program provides tax relief to persons who purchase vehicles, vessels, and aircraft from immediate family members. The program has two rationales. First, it is based on the view that families should be treated as units, so that transactions between family members should not be taxed. Second, it facilitates tax administration because intrafamily transactions are typically not at "arms length," and thus, the price paid could be difficult to determine and may not reflect the true market value of the vehicle, vessel, or aircraft.

New Vehicles Sold to Foreign Residents For Foreign Shipment

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6366.2.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of any new, noncommercial vehicle manufactured in the United States which is purchased by a foreign resident for shipment outside of the United States. The purchaser must (1) be a foreign resident, (2) arrange for purchase through an authorized dealer in the foreign country before arriving in the United States, and (3) obtain an "in-transit" permit from the California Department of Motor Vehicles (DMV) which is valid for up to 30 days. In addition, the retailer must ship or drive the vehicle out of the United States prior to the expiration of the in-transit permit.

RATIONALE

The program's intent is to promote the purchase and export of American-made passenger vehicles, and to increase tourism in the state. The program benefits foreign tourists by reducing the cost of purchasing an American-made car in California. Foreign countries currently provide similar programs for American citizens to purchase and operate vehicles overseas prior to their being shipped here. For California residents, such vehicles would become subject to the use tax upon registration.

COMMENTS

This program was established by Chapter 762, Statutes of 1989 (SB 442, Kopp) and became operative on January 1, 1990.

OCCASIONAL SALES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6006.5 and 6367.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Major
1997-98	Major
1998-99	Major

DESCRIPTION

This program exempts occasional sales from taxation. An "occasional sale" is defined as either of the following types of transactions:

- The transfer of tangible personal property (except vehicles, vessels, and aircraft, which have their own program) when the seller is not required to hold a seller's permit. (A seller need not hold such a permit if he or she makes fewer than three sales for a substantial amount of money in a 12-month period.)
- Any transfer in which substantially all
 of the property held by an entity is
 transferred (except vehicles, vessels,
 and aircraft, which have their own
 program), provided that the real or
 ultimate ownership of such property is
 substantially similar to that which existed before the transfer. (This type of
 transfer most commonly involves corporate acquisitions and/or mergers.)

RATIONALE

This program exists in order to simplify tax administration. By exempting sales made by persons with a small number of sales, the program greatly reduces the number of persons and businesses that must register and file tax returns with the State Board of Equalization. Many of these additional sales would generate little additional revenue. For sales of *entire* businesses, the program's rationale is that these transactions are primarily changes in financial arrangements, as opposed to retail-related, even though the transfer of tangible property generally is included.

COMMENTS

This exemption constitutes a major tax expenditure program from a fiscal perspective. It recognizes that enforcing sales tax collections by individuals making small private sales (such as a garage sale) is not realistically feasible. However, there is no limit on the value of any individual occasional sale, so that a seller *can* in fact make large (though infrequent) sales without incurring a tax liability.

OCCASIONAL SALES OF VEHICLES, VESSELS, OR AIRCRAFT

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6281, 6282, and 6283.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program provides a sales tax exemption for occasional sales of vehicles, vessels, or aircraft. Specifically, any seller who is not required to hold a seller's permit for such sales by reason of the number, scope or character of the sales is exempt from the payment of the tax. For instance, the sale of vehicles by individuals would be exempt from taxation.

This program also exempts from taxation the transfer of certain types of vehicles and other property when, after the transfer, the real or ultimate ownership of the property is substantially similar to that which existed before the transfer. The program applies, among other items, to certain mobilehomes, commercial coaches, vehicles, vessels, and aircraft, when such property is included in the sale of an entire business that includes the transfer of substantially *all* the assets of that business.

The program does not apply to sales of vehicles by a retailer who is licensed under the California Vehicle Code as a manufacturer, remanufacturer, dealer, or dismantler. Further, the exemption does not apply to the rental payments made under a lease of tangible personal property.

RATIONALE

The rationale for this program is to simplify administration of the sales tax. Sales of vehicles, vessels, and aircraft by individuals or businesses that do not regularly deal in these items would be difficult to identify and tax. This is because the seller may not be registered, or the sale is outside the seller's regular sphere of activities.

The business-related program provides tax relief to owners of businesses that are sold or reorganized. The program's rationale is that the real or ultimate ownership of the assets is unchanged.

COMMENTS

The program does not provide a use tax exemption. The buyer must pay use tax when registering the vehicle, vessel, or aircraft unless some other exemption applies.

The business-related program is identical to the occasional sale exemption provided for the transfer of other property in the sale of an entire business (see program entitled "Occasional Sales"). The occasional sale exemption, however, specifically excludes vehicles, vessels, and aircraft, which are addressed in this exemption.

OCCASIONAL SALES OF OTHER PRODUCTS BY HAY PRODUCERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6006.5 (c).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts a producer of hay from liability for sales and use taxes on occasional sales of tangible personal property other than hay. To qualify, the sales must not be of such number, scope, and character that they would be taxable if the producer were not also selling hay.

RATIONALE

This program provides tax relief to the consumers of tangible personal property, such as tractors, sold by hay producers. The program is based on the rationale that it equalizes treatment of hay producers and other farmers. In the absence of this program, a farmer who is required to hold a seller's permit because some of his or her hay sales are taxable (for example, sales to private horse owners) would also be required to pay taxes when he

or she sells on an occasional basis any implements used in producing the hay. (This is because *all* of the sales at retail of a person holding a seller's permit are subject to the sales and use tax.) However, as program proponents point out, other farmers, such as lettuce producers who conduct no taxable retail sales, do *not* have to hold a seller's permit and, consequently, do *not* have to collect sales tax on occasional sales of their farm equipment. This program extends this tax treatment to hay farmers.

COMMENTS

Other businesses (such as manufacturers) which generally hold seller's permits but do not benefit from programs such as this, are subject to the sales tax upon sales of tangible assets of their business.

MEMBERSHIP FEES CHARGED BY CONSUMER COOPERATIVES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6011.1 and 6012.1.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the membership fees charged by consumer cooperatives. The imputed value of any labor provided to a cooperative by a member in lieu of monthly membership fees also is tax exempt. In the absence of this program, the Board of Equalization could consider cooperative membership fees (both monetary and in-kind payments) as part of the purchase price of goods sold by consumer cooperatives and, therefore, taxable.

RATIONALE

This program provides tax relief to members of consumer cooperatives to the extent that sales and use taxes levied on membership fees ordinarily would increase the costs of belonging to, and buying from, such cooperatives. At the time the program was adopted, proponents argued that the membership fees cooperatives levy are not directly related to the prices they charge for products. Rather, they argued that cooperatives are akin to organizations such as sports clubs, whose membership fees are not directly related to the frequency of facility use. Thus, the program's proponents argue that it provides tax equity between the cooperatives and other organizations such as private clubs.

CLOTHING ALTERATIONS BY CLOTHES CLEANING AND DYEING BUSINESSES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6018.6.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program defines an operator of a qualified state-licensed clothes cleaning or clothes dyeing business as the consumer (as opposed to the retailer) of the materials and supplies used or furnished in altering clothing. While the operators pay sales taxes on these materials, the value of the alterations are exempt from the sales tax. Such operators thus pay sales tax on the price they *pay* rather than on the price they *charge* for the materials.

To qualify for the program, the business involved may receive no more than 20 percent of its gross receipts from the alteration of garments. Also, the business may operate only as a pick-up and delivery point for garment cleaning, or provide spotting and pressing services (but not garment cleaning), or

operate a garment cleaning or dyeing plant on the premises. In addition, 75 percent of the business' total receipts must represent charges for garment cleaning or dyeing services.

RATIONALE

This program provides tax relief to the customers of cleaners that have their clothes altered. According to the State Board of Equalization, the basic rationale for this program is that it simplifies the process of tax administration. This is because, in the absence of the program, many small cleaning establishments would be required to register as retailers, even though clothing alterations are an incidental part of their overall operations.

FLAGS SOLD BY VETERANS' GROUPS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6359.3.

Estimated Revenue Reduction (In Millions)	
Minor	
Minor	
Minor	

DESCRIPTION

This program defines nonprofit veterans' organizations as consumers of the U.S. flags they sell, provided that the proceeds of the sales are used exclusively to further the purposes of the veterans' organization. As defined consumers, such organizations pay sales tax on the price they *pay* rather than on the price they *charge* for the flags they sell, resulting in a partial tax exemption based on this price differential.

RATIONALE

This program provides an incentive for persons to support the activities of nonprofit veterans' organizations by granting tax relief to those who purchase U.S. flags sold by the organizations. The program has the effect of partially exempting the retail value of such flags from taxation, thereby increasing their marketability. The underlying rationale for the program is the view that the purposes and activities of veterans' organizations are worthy of public financial support.

VENDING MACHINE SALES OF NONPROFIT OPERATORS

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Section 6359.45(a).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program treats as consumers certain operators of vending machines that dispense items selling for 15 cents or less. As such, the sales and use tax they are subject to is based on the price they *pay* for the items sold rather than based on the *sales* price. In order to qualify for the program, an operator must be a nonprofit, charitable, or educational organization.

RATIONALE

This program provides tax relief to qualifying vending machine operators and their customers, to the extent that sales and use taxes levied on the full retail price of dispensed items (versus their cost to operators) would ordinarily increase their prices and reduce their

marketability. One rationale for the program is that the levying of sales and use taxes on individual vending machine products is impractical, since the exact amount of the tax cannot be conveniently incorporated into the coinage charge. A second rationale is that qualifying organizations provide socially beneficial services, and therefore, their fundraising efforts and other activities are worthy of public financial support.

COMMENTS

The effect of this program is limited to nonfood items. Food items sold in vending machines for no more than 15 cents (or 25 cents for bulk products) are effectively exempt from taxation, regardless of whether the vendor is nonprofit or profitmaking.

PHOTOCOPY SALES BY LIBRARIES

Program Characteristics

Tax Type: Sales and Use Tax

Authorization: California Revenue and Taxation Code

Section 6359.45 (b).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program defines certain libraries or their contracted vendors as the consumers of photocopies sold through coin-operated photocopying machines. Consequently, libraries pay sales tax on the purchase of the photocopy machine and supplies, rather than on the sales price of a photocopy. This has the effect of partially exempting the retail value of a photocopy from taxation. This program applies to any library district, municipal library, or county library. The photocopies must be sold from a coin-operated machine located at the library facility in order to qualify for the exemption.

RATIONALE

This program provides tax relief to qualifying libraries and their patrons by reducing the costs of providing photocopying services. The program has several rationales. One is that the levying of sales and use taxes on individual machine-sold photocopies is impractical, since the exact amount of the tax cannot be conveniently incorporated into the coinage charge. Another is that photocopy services serve a worthy public goal of enabling library patrons to make better use of library facilities and information.

PRISONER-OF-WAR BRACELET SELLERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6360.

Estimated Revenue Reduction (In Millions)	
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program defines qualified sellers as consumers of bracelets commemorating American prisoners of war, and thus bases their taxation on the prices the sellers *pay* for the bracelets rather than the sales price. To qualify for the program, a seller must be an organization which (1) is formed and operated for a charitable purpose and (2) qualifies for the welfare (local property tax) exemption. In addition, the organization's profits must be used exclusively to further the purposes for which it has been established.

RATIONALE

This program provides tax relief to qualifying bracelet-distributing charitable organizations and their patrons. It accomplishes this by reducing the costs or prices at which such bracelets may be provided or sold, thereby increasing the scope of their distribution. The program's underlying rationale is that the distribution of commemorative prisoner-of-war bracelets furthers the effort to locate and identify prisoners of war.

COMMENTS

The California Department of Veterans Affairs indicates that, to its knowledge, only a very limited number of prisoner-of-war bracelets are currently being sold.

VETERANS MEMORIAL LAPEL PINS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6360.1.

Estimated Revenue Reduction	
(In Millions)	
Amount	
Minor	
Minor	
Minor	

DESCRIPTION

This program exempts from taxation the sale, storage, or use of "Buddy Poppies" or any other symbolic impermanent lapel pin that (1) memorializes military veterans killed in foreign wars and (2) is sold by veterans' groups.

RATIONALE

This program provides an incentive for persons to support work done by veterans' organizations by providing tax relief for those who purchase lapel pins sold by these organizations. The Buddy Poppy program, for example, has been used to raise funds to assist disabled veterans. The underlying rationale for this tax exemption program is the view that the purposes and activities of veterans' organizations are worthy of public financial support.

QUALIFIED SALES OF YOUTH GROUPS

Program Characteristics

Tax Type: Sales and Use Taxes.

Authorization: California Revenue and Taxation Code

Section 6361.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program treats qualified youth group organizations as consumers of the food products, nonalcoholic beverages, and certain other items that they sell. This has the effect of either fully exempting (in the case of most food products, which are not subject to the sales tax when purchased by these groups, but could be subject to sales tax when resold by them) or partially exempting (for other items for which the sales tax on their purchase price is less than the sales tax on the resale price) the retail value of these products from taxation. Nonfood items must be made by members of the organization in order to receive this treatment. In order to qualify for the program, a group must (1) use its profits exclusively to further its purpose(s), (2) conduct sales only on an intermittent or irregular basis, and (3) be included in one of the following categories:

- Nonprofit groups that are nondiscriminatory and provide a program of competitive sports or promote good citizenship.
- Groups sponsored or affiliated with a qualifying educational institution.
- Specific named groups, including the Young Men's Christian Association,

Boy Scouts, Girl Scouts, Bobby Sox, Future Farmers of America, and Vocational Industrial Clubs of America.

RATIONALE

This program provides tax relief to qualifying youth organizations and to individuals and businesses who purchase products they sell. It accomplishes this by reducing the costs and prices at which these products can be provided and sold, thereby making them more marketable and increasing their sales potential. The program thus has the effect of giving incentives for such organizations to undertake fund-raising activities and for patrons to support them. The program's rationale is that the objectives and activities of the qualifying organizations are socially desirable and worthy of public financial support.

COMMENTS

Youth groups often operate food stands at sports events and fairs, or organize fundraising meals, in order to support their activities. Many of these food sales *would* be taxable in the absence of this program. This is because the food is sold in a hot, prepared form (such as hamburgers or hotdogs), as a meal, or for onsite consumption at an event. Since the food supplies purchased by these organizations are not taxable under the general food

exemption, this program results in a full exemption for their sales to consumers (with the exception of carbonated beverages). The program also applies to nonfood items that are made by members of the organization itself, in which case the group pays sales tax on the materials and supplies that it uses, but the finished item is not taxable.

Chapter 116, Statutes of 1990 (AB 520, Klehs), eliminated a previous requirement that youth groups that were not specifically named in statute were required to obtain prior approval from the Board of Equalization in order to qualify for this program.

YEARBOOK AND CATALOG SALES BY STUDENT ORGANIZATIONS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6361.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program defines qualified student organizations as consumers of the yearbooks and catalogues they distribute. Consequently, the organizations pay sales tax on their *purchase* price of such items, rather than on the price at which they *resell* them. This has the effect of partially exempting from taxation the retail value of these items. The program applies to any public or private school, school district, county office of education, or student organization.

RATIONALE

This program provides tax relief to student organizations and students, to the extent that sales and use taxes on the full retail value (versus acquisition cost) of yearbooks and catalogues ordinarily would increase their prices. The rationale for the program is that such catalogues and yearbooks are a fundamental part of the schooling experience, and therefore, the costs of such items should not be increased by fully taxing such purchases.

REPLACEMENTS FOR DESTROYED MUSEUM EXHIBITS

Program Characteristics		
Tax Type:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6366.3.	

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from taxation the sale or use of replacement exhibits for a qualified museum, or for a public art display of the state or a local government. The program requires that the property be acquired to replace property physically destroyed by a calamity within three years after its occurrence, and that it be purchased and used exclusively for display purposes within the museum.

To qualify, a museum must either (1) have a significant portion of its space open to the public without charge, (2) be open to the public without charge for not less than six hours per month during any month when the museum is open to the public, or (3) be open to a segment of the student or adult popula-

tion without charge. In addition, the museum must be operated by or for a local or state government entity, or by a qualified nonprofit organization.

RATIONALE

This program provides tax relief to qualified museums after they have incurred damage from disasters, including fire, flooding, or earthquakes. The program's rationale is that museums provide a valuable cultural and educational service and, as such, they are worthy of public financial support.

COMMENTS

As described under a separate program, generally, original artwork purchased by a museum is exempt from taxation.

SALES BY PTAS, CO-OP NURSERY SCHOOLS, AND FRIENDS OF THE LIBRARY

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization:	California Revenue and Taxation Code Section 6370.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program treats as consumers nonprofit Parent Teacher Associations (PTAs), Friends of the Library (or equivalent organizations), and nonprofit parent cooperative nursery schools. As consumers, such organizations pay taxes on the prices they *pay* rather than on the prices they *charge* for items they sell to raise funds. This has the effect of partially exempting from taxation the retail value of such items. The program requires that any profits derived from the sales of such property be used for furthering the purposes of the organization.

RATIONALE

This program provides tax relief to qualifying organizations and their patrons, to the extent that taxation of the full retail price of the property these organizations sell would increase their prices and reduce their sales potential. The program thus provides an incentive for organizations to operate, and patrons to support, qualifying activities. The program's underlying rationale is that the goals and activities of these organizations are socially desirable, and thus worthy of public financial support.

RUMMAGE SALES BY QUALIFIED NONPROFIT **ORGANIZATIONS**

Program Characteristics		
Тах Туре:	Sales and Use Tax	

California Revenue and Taxation Code

Section 6370.5.

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	Minor	
1997-98	Minor	
1998-99	Minor	

DESCRIPTION

Authorization:

This program treats nonprofit organizations that perform auxiliary services to any city or county museum as the consumers of goods sold by those organizations at qualified rummage sales. As consumers, such organizations pay tax on the price they pay rather than on the price they charge for items they sell to raise funds. The effect of this is to limit the amount of sales and use taxes levied on such property. In order for the program to apply, the property must be sold at an annual rummage sale which must have been held during each of the five consecutively preceding years, and profits from the sale must be used exclusively for furthering the purposes of the organization.

RATIONALE

This program provides tax relief to qualified charitable organizations and their patrons, and (indirectly) to the museums which they support. It does this to the extent that the partial sales and use tax exemption on rummage sales stimulates such sales, and thereby increases the amount of funds which charitable organizations and museums are able to raise from rummage sales. The program's rationale is that museum-related activities are socially beneficial and deserving of public financial support.

COMMENTS

This program results in a full tax exemption for donated items sold at these rummage sales.

HANDCRAFTED ITEMS SOLD BY QUALIFIED ORGANIZATIONS

Program Characteristics		
Tax Type:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6361.1.	

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year Amount	
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program treats qualified organizations as consumers of tangible personal property if:
(1) such property is handcrafted and designed, created, or made by either individuals with developmental disabilities or children with severe emotional disturbances who are members of or receive services from the organization; (2) the price of such property does not exceed \$20; (3) the organization's sales are made on an intermittent basis; and (4) the profits from sales are used exclusively for promotion of the organization.

In order to qualify, an organization must: not discriminate on the basis of race, sex, nationality, or religion; have tax-exempt status as defined under Section 501(c)3 of the Internal Revenue Code; and primarily provide services to either individuals with developmen-

tal disabilities or children with severe emotional disturbances.

RATIONALE

There exist several underlying rationales for this program. One is to simplify tax administration in a manner similar to the exemption for occasional sales discussed elsewhere in this report. The program also provides tax relief to charitable organizations and their clientele, to the extent that it reduces the prices of items they sell. The program provides an incentive for individuals to purchase such items because of their reduced prices. To the extent that the lower prices increase sales, this provides additional funds for services to individuals with certain disabilities or emotional disturbances. This program is similar to the sales and use tax exemption provided for sales by qualified charitable organizations.

CHARITABLE ORGANIZATION SALES AND DONATIONS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6375.

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99	NA	

DESCRIPTION

Commonly known as the "welfare exemption," this program exempts from taxation the sale or use of goods made, prepared, assembled, or manufactured by qualified charitable organizations. In order for the program to apply, an organization must qualify for the welfare (local property tax) exemption and be engaged in the relief of poverty and distress. In addition, the organization's sales and donations are exempt only if they are made principally to assist purchasers or donees in poverty or distress.

RATIONALE

This program provides tax relief to charitable organizations and their clientele, to the extent that it reduces the prices and costs of providing property to disadvantaged persons. The program also provides an incentive for individuals to purchase merchandise sold by charitable organizations. It does this by removing the sales tax on such merchandise, thereby reducing the prices at which the merchandise can be sold. To the extent that the organization's sales are increased as a result,

the amount of funds available for the relief of poverty and distress is increased.

The program's underlying rationale is that the qualifying organizations provide a socially desirable service in making property available to distressed persons and, therefore, are deserving of public financial support.

COMMENTS

This program provides a tax exemption for sales in stores operated by Goodwill Industries and similar organizations. In practice, the exemption applies to *all* sales in these stores, and no attempt is made to determine whether the purchaser is needy or not.

Donations were included in this program by Chapter 1447, Statutes of 1989 (SB 874, Doolittle). This was done because previously, charities that purchased goods tax-free using their resale permit found that they became liable for tax when they donated these goods, because making a gift constituted a taxable use of the property.

PROPERTY LOANED TO EDUCATIONAL PROGRAMS

Tax Type: Sales and Use Tax. Authorization: California Revenue and Taxation Code Sections 6202.7 and 6404.

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99	NA	

DESCRIPTION

This program exempts from taxation the loan by retailers of certain tangible personal property to qualified educational institutions.

Specifically, the program exempts:

- Loans of tangible personal property to school districts for educational programs.
- Loans of motor vehicles to the University of California (UC) or the California
 State University (CSU) system for exclusive use: (1) in an approved driver education teacher preparation certification program or (2) by an employee of the UC or CSU system, so long as the loan is approved by the President or Chancellor of the university and the retailer is not guaranteed automotive-related business from the university.
- Loans of vehicles to an accredited private or parochial secondary school for exclusive use in an approved driver education and training program.
- Loans of motor vehicles to a veterans' hospital or other nonprofit institution, to provide instruction in the operation of specially equipped motor vehi-

cles to disabled veterans.

Under existing law, if a retailer makes use of property that is ostensibly held for sale, he or she ordinarily must pay use tax on the wholesale price of the property. Loans of such property are considered "uses" of the property by the retailer and, therefore, are taxable unless otherwise exempted.

Example. In the absence of this program, an automobile retailer who loans a vehicle at no cost to a high school driver training course would pay use tax on the dealership's cost of the vehicle. This is because most retailers are considered "consumers" of merchandise that they use themselves or loan to others. This program exempts from taxation such loans to qualifying educational institutions.

RATIONALE

This program provides tax relief to qualified educational institutions and the students who use the qualified loaned property. It does this to the extent that exemption of sales and use taxes on such loans enables these educational institutions to service more students because of reduced costs. In addition, students who pay fees for the affected programs may pay less because of the reduced costs. The underlying rationale for the program is that providing equipment and vehicles to educational institutions is a desirable social goal worthy

of public financial support.

New Clothing Donated to Elementary School Children

Program Characteristics		
Тах Туре:	Sales and Use Tax.	
Authorization:	California Revenue and Taxation Code Section 6375.5.	

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99	NA	

DESCRIPTION

This program exempts from taxation the sale of children's new clothing when the clothes are sold to a qualified nonprofit organization. In order for the program to apply, the clothes must be sold to a nonprofit organization organized and operated for charitable purposes, possessing tax-exempt status and engaged in poverty and distress relief. The clothes must be distributed, free of charge, to needy elementary school children.

RATIONALE

This program provides tax relief to nonprofit organizations which distribute free clothes to children. The underlying rationale for the program is that such tax relief increases the amount of clothing which nonprofit organizations may acquire with their available resources, and thereby enables them to better

meet the needs of the children they service. The program exists in recognition of the view that providing such clothes is a socially beneficial activity worthy of public financial support.

COMMENTS

This program is similar to the general exemption for sales and donations by charitable organizations. However, it does differ in three ways. First, the exemption applies to *purchases* by, rather than sales or use by, the charity. Thus, it is useful to charities that do not have resale permits. Second, there is no requirement that the donating charity qualify for the welfare exemption under the local property tax. Third, there is no requirement that the charitable organization prepare, assemble, or make the donated items.

FIRST \$400 OF FOREIGN PURCHASES HAND-CARRIED INTO CALIFORNIA

Tax Type: Use Tax. Authorization: California Revenue and Taxation Code Section 6405.

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	Minor	
1997-98	Minor	
1998-99	Minor	

DESCRIPTION

This program exempts from the use tax the first \$400 of purchases made by state residents in a foreign country and personally hand-carried into California. Only one such exemption can be claimed for any 30-day period, and purchases sent or shipped into California do not qualify for the exemption.

RATIONALE

This program provides tax relief to California residents returning from overseas with purchases that otherwise would be subject to the use tax. The exemption originally was enacted as part of a new state program which seeks to collect use taxes on foreign purchases. Such taxes generally had not been collected prior to 1990 due to administrative difficulties.

The program is largely rationalized on administrative grounds. The exemption recognizes that the state's efforts to collect the use tax on foreign purchases is dependent on the federal government's duty collection procedures. The U.S. Customs Service recently

began to provide the state with customs declarations filed by returning Californians. The U.S. Customs Service does not require payment of duties on the first \$400 of foreign purchases and keeps no useable records of travelers entering the state with purchases of less than \$400. Consequently, the state has no cost-effective means at present to collect use tax from travelers declaring less than \$400 of foreign purchases.

Although the state could attempt to collect the use tax on the first \$400 of purchases brought into the state by travelers who are subject to customs duties, the administrative costs would be prohibitive.

COMMENTS

The Board of Equalization started collecting customs declarations on October 1, 1990. This program, which was established by Chapter 1533, Statutes of 1990 (SB 2455, Morgan), exempts \$400 of the taxable purchases from each billing, for a maximum state revenue loss of \$24 per billing.

CHARITABLE DONATIONS MADE BY SELLERS

	Program Characteristics
Tax Type:	Use Tax.
Authorization:	California Revenue and Taxation Code Section 6403.

Estimated Revenue Reduction		
(In Millions)		
Fiscal Year	Amount	
1996-97	NA	
1997-98	NA	
1998-99	NA	

DESCRIPTION

This program provides a use tax exemption for property donated by any seller to specified educational institutions, charitable organizations, and nonprofit museums located in California.

RATIONALE

This program provides tax relief to sellers who donate property to educational and charitable organizations and museums. Generally, the purchase of goods solely for resale does not trigger the payment of sales or use tax on the purchase. Rather, tax is collected only on *retail* sales—that is, sales to someone who will actually make final use of the goods. If, however, property originally bought for resale is instead used by the seller rather than resold, the seller must pay use tax. This includes donations of property, which are considered a "use" of the property by the seller. This program exempts sellers from paying

use tax on items donated to qualifying organizations. The program's intent is to give added incentive to donate property to non-profit organizations and museums, the rationale being that such organizations serve a public purpose and are deserving of public financial support.

COMMENTS

This program was enacted by Chapter 905, Statutes of 1988 (SB 2508, McCorquodale), and originally applied only to persons engaged in retail sales activity who donated property. The program was expanded by Chapter 1387, Statutes of 1989 (SB 1226, Campbell), however, to include *all* sellers (including wholesalers). Chapter 1387 also restricted the program to donations used exclusively for display in the case of non-profit museums, and required qualifying museums to meet minimum standards for public access.

AUCTIONS INVOLVING NONPROFIT ORGANIZATIONS

Program Characteristics		Estimated R	Estimated Revenue Reduction	
Tax Type:	Sales and Use Tax.	(In Millions)	(In Millions)	
		Fiscal Year	Amount	
Authorization:	California Revenue and Taxation Code Section 6363.2.	1996-97	Minor	
		1997-98	Minor	
		1998-99	Minor	

DESCRIPTION

This program exempts from taxation the gross receipts from the sale, storage, use, or consumption of tangible personal property sold to a bidder at an auction conducted by, or affiliated with, a nonprofit organization. The purpose of the auction must be to obtain revenue for the funding of a shelter for homeless individuals and families, and those revenues obtained must be expended for that purpose. The exemption does not apply to sales at an auction conducted more than once every 12 months.

RATIONALE

This program provides tax relief to charitable organizations and their clientele by exempting the sales and use tax on merchandise sold at auction. As a result, it increases the amount of funds available to charitable organizations for funding shelters for the homeless. The program also eases the administrative burden since the administrative costs associated with collecting taxes from such infrequent sales could exceed the amount of taxes collected.

SALES BY THRIFT STORES OPERATED BY NONPROFIT ORGANIZATIONS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6363.3.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation the sale, storage, consumption, or use of used clothing, household goods, or other items sold by thrift stores operated by nonprofit organizations. It has a sunset date of January 1, 2002. The thrift store involved must be operated for the purpose of raising revenues for funding medical and social services for chronically ill individuals, with at least 75 percent of its net revenues being expended for these purposes.

RATIONALE

This program provides tax relief to nonprofit organizations (such as hospital auxiliary organizations) that raise revenues for the purpose of funding medical and social services for the chronically ill. The program's underlying rationale is that the qualifying organizations are providing a socially desirable service, and therefore deserve public financial support.

OPTION TO PAY TAX ON COST RATHER THAN LEASE RECEIPTS

Program Characteristics

Tax Type: Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6006 (g) (5) and 6010 (e) (5).

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program provides that owners of property engaged in the business of leasing such property to others may choose to pay *sales* tax based on the *purchase price* that they paid for the property, rather than pay *use* tax on their *lease receipts*. To qualify, property must be leased in substantially the same form as it was acquired by the lessor. This program does not apply, however, to the rental of video cassettes, which are taxed solely on the basis of rental receipts under California Revenue and Taxation Code Section 6006 (g) (7).

RATIONALE

This program provides tax relief to lessors and lessees of qualified property. The rationale underlying the program is to facilitate the compliance of the lessor with the state sales tax code and to simplify tax administration. The program accomplishes these ends by allowing businesses to pay the sales tax once, upon the purchase of the item, rather than requiring the

lessor to pay the tax repeatedly based on the property's rental receipts.

COMMENTS

Under this program, a lessor can choose the most advantageous tax strategy for any specific situation. The State Board of Equalization indicates that lease receipts are chosen as the basis of tax for about 75 percent of all leased property. This approach is preferred by car rental companies, for example. Most rental cars are resold after a year or two, so that rental receipts for these cars are significantly less than their purchase price. Thus, paying tax on the rental receipts results in a smaller total tax liability for the rental company than paying tax based on the purchase price. Paying tax on lease or rental receipts also reduces the amount of capital required for lessors to purchase property initially. In the case of property that is leased for its full economic life, paying sales tax on the purchase price rather than on lease receipts generally would result in a smaller tax liability.

TAX LIABILITY ON "BAD DEBTS"

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6055 and 6203.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts retailers from paying sales and use taxes due on accounts which have been determined to be uncollectible.

RATIONALE

This program provides tax relief to businesses which have incurred financial losses due to their inability to collect money from customers who have not paid their bills. The underlying rationale for the program is that businesses, especially small firms, can suffer considerable hardships when they are unable

to collect money from customers who have purchased goods using credit. Such financial losses can impair a firm's ability to pay taxes, since the funds to pay these taxes normally are collected from its customers.

COMMENTS

The above-cited rationale for this program is strongest when retailers can show that they have executed proper caution when granting credit to consumers. In the absence of such care, however, the rationale loses strength.

ACQUISITION SALE-LEASEBACK ARRANGEMENTS

Program Characteristics	
Tax Type:	Sales and Use Tax.
Authorization: California Revenue and Taxation Code Section 6010.65.	

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from sales and use taxation any transfer of the title to, or lease of, property under a qualifying "acquisition sale-leaseback." An acquisition sale-leaseback is a financing arrangement wherein the purchaser of property sells that property to a third party and then leases it back from that third party. These transactions generally are "on paper" only and do not involve any physical transfer of the property. In order to qualify for this program, an acquisition sale-leaseback must be consummated within 90 days of the first functional use of the property, and the sales or use tax must have been paid on the initial purchase of the property.

RATIONALE

This program reduces the cost of acquiring property financed through sale-leaseback arrangements. It does so by eliminating sales tax on the sale to the lessor or, alternatively, the use tax on the lease payments to the lessee. The rationale for the program is that qualifying sale-leasebacks are financing arrangements similar to a mortgage. On that basis, it is argued that taxing the sale-leaseback transaction, in addition to taxing the initial purchase of the property, would amount to double taxation.

COMMENTS

Most sale-leaseback transactions probably would be exempt from sales and use taxes, even in the absence of this program. This is because the courts have ruled (prior to the establishment of this program) that no taxable sale occurs when the sole object of a sale-leaseback is to obtain financing for the purchase of equipment (*Cedars-Sinai Medical Center v. State Board of Equalization*, 162 Cal. App.3d.1182). This program was enacted by Chapter 558, Statutes of 1990 (AB 3382, Baker), in part to simplify tax administration by setting a specific 90-day window in which sale-leasebacks must be completed in order to be tax exempt.

FACTORY-BUILT SCHOOL BUILDINGS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6012.6.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation 60 percent of the sales price of qualified factory-built school buildings. Additionally, it specifies that the place of sale is the retailer's place of business, regardless of whether the sale includes installation or the building is placed on a permanent foundation.

RATIONALE

The intent of this partial exemption is to equalize tax treatment of factory-built school buildings with that of site-built buildings. Generally, the sales and use tax applies only to the building materials used to construct a site-built building, rather than to the full price of the completed building. It was determined that approximately 40 percent of the sales price of a factory-built school building represents the value of the building materials and, thus, the remaining 60 percent of the price of such school buildings should be exempt from taxation.

This program is consistent with the 60 percent exemption which also applies to factory-built housing, described under a separate program discussed earlier (see program entitled, "Factory-Built Housing").

COMMENTS

This program was enacted by Chapter 816, Statutes of 1989 (AB 1051, Leslie) and Chapter 763, Statutes of 1990 (AB 4029, Leslie).

The Board of Equalization (BOE) adopted regulations a few months prior to enactment of this program which classified essentially all installations of modular buildings, including factory-built school buildings, as construction projects so that they would be taxed as if constructed on the site. Under that treatment, a purchaser, such as a school district, pays sales tax only on the value of fixtures and equipment supplied with the building. The manufacturer pays sales or use tax on the materials used to make the building, but no tax is applied to the value added by the manufacturer.

According to BOE, the total tax liability for manufactured buildings under this regulation is similar to the tax liability under this program (that is, about 40 percent of the total value is taxed). Therefore, this program has no significant impact on the amount of tax revenue compared with the board's regulatory interpretation of general sales and use tax law.

Under the board's regulations, however, the local share of sales tax revenues would have been allocated to both the localities where the manufacturer's suppliers were located and to the locality where the building was installed.

The main purpose of enacting this program was to ensure that the city and county in which the building manufacturer is located continue to receive the local portion of the sales tax.

ENDANGERED ANIMAL AND PLANT SPECIES

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Sections 6010.50 and 6366.5.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from taxation the sale or use of endangered or threatened animal or plant species, provided that the buyer and seller are both nonprofit zoological societies.

RATIONALE

The intent of this program is to provide tax relief for zoos that breed and exchange animals and plants of endangered species (primarily animals). Some zoos specialize in the development and breeding of certain animal species. Prior to enactment of this program,

zoos had been assessed back taxes for making animal exchanges. The program's rationale is that it is a worthy public goal to encourage zoos to breed and exchange endangered species.

COMMENTS

This program does not apply when zoological societies purchase animals or plants from for-profit sources. This program was established by Chapter 937, Statutes of 1989 (AB 804, Peace).

INVESTMENTS BY MANUFACTURERS

Program Characteristics

Tax Type: Sales and Use Tax.

Authorization: California Revenue and Taxation Code

Section 6377.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	Amount
1996-97	<i>\$5</i>
1997-98	6
1998-99	6

DESCRIPTION

This program provides a partial exemption from sales and use tax for manufacturing, research, and recycling property purchased by "new businesses." The exemption provided under the program is equal to five cents per dollar of the sales and use tax normally owed, which represents the portion of the sales and use tax levied by the state for the General Fund. (The taxpayer still has to pay the additional statewide sales and use tax and any local sales and use taxes.)

To qualify, a business must have (1) commenced business activities in California after 1993, and (2) been in existence for fewer than three years. In addition, the business must be engaged in certain lines of business defined in the U.S. Standard Industrial Classification Manual as "manufacturing" activities.

The program covers property costs that are considered "capital expenditures." (It also includes the value of any capitalized labor costs that are directly related to the construction or modification of these expenditures.) Eligible property is depreciable property (such as machinery and computers) or computer software used primarily in (1) manufacturing, research, pollution control, or recycling activities, or (2) maintaining, repairing, measuring, or testing property

used in such activities. In addition eligible property includes, for certain activities, special purpose buildings and foundations that are primarily used in connection with manufacturing, refining, processing, fabricating, or research and storage.

A taxpayer may claim a tax refund under this program if sales and use taxes were paid on qualified costs and if the taxpayer was eligible for this exemption, but did not claim it. The program sunsets January 1, 2001, or earlier under certain conditions.

RATIONALE

This program provides an incentive for qualified taxpayers to expand manufacturing and research property in California. It does this by offsetting a portion of the costs incurred through a partial sales and use tax exemption. It provides tax relief to new businesses that may not be able to claim the Manufacturer's Investment Income Tax Credit (which is available to all businesses) because they do not have positive tax liabilities (which is common among new businesses with large startup expenses, and thus, similarly large tax deductions for business expenses and losses). Thus, this program tries to equalize tax treatment between new businesses and well established businesses that may be able to readily claim the income tax credit.

COMMENTS

To the extent that this program reduces the cost of capital acquisition to businesses, it results in an unknown expansion in business activity. Also, refer to comments under the

PIT and BCT income tax program entitled "Manufacturer's Investment Tax Credit."

Pursuant to Chapter 323, Statutes of 1998 (AB 2798, Machado) this program was expanded to include teleproduction and post-production equipment.