



California New Car Dealers Association

November 21, 2008

The Honorable Arnold Schwarzenegger
Governor's Office
First Floor, State Capitol
Sacramento, CA 95814

Re: Proposed Sales Tax Increase and Expansion

Dear Governor Schwarzenegger:

The California New Car Dealers Association (CNCDA) is a statewide trade association that represents the interests of 1,200 franchised new car and truck dealers. CNCDA members are primarily engaged in the retail sale and lease of new and used motor vehicles, but also engage in automotive service, repair and part sales. We are writing today to advise you of a unanimous resolution adopted by our board of directors to oppose your proposed 1.5% sales tax increase and expansion of sales tax to automotive repair. Our dealer members believe that your proposal will harm the economy, lead to more dealership closures and unemployment, and further depress new vehicle sales.

Sales Tax Increase

- ➔ New vehicle registrations in California declined 18.5% during the first three-quarters of this year versus the same period last year. October and November sales have dropped by more than 30%.
- ➔ Since the first of the year, 106 franchised new car and truck dealers have gone out of business (compared to 20 during all of last year) and over 30,000 dealership employees have been laid off by closed and struggling dealerships.
- ➔ Historically, 20% of California's sales tax is generated by new car dealerships. Last year our dealer members collected \$5.6 billion in sales tax revenue, however, the steep decline in truck and SUV sales coupled with an increase in the sale of more fuel efficient, but less expensive vehicles, has resulted in a dramatic decline in sales tax revenue collected by our members.
- ➔ The current statewide sales tax rate is 7.25%, but many counties and other jurisdictions have higher rates (Alameda's rate is 8.75% and LA's new rate under Proposition R will also be 8.75%). Your proposed 1.5% increase would result in an average state and local total rate of about 9.5% (the highest in the country) and would raise the Alameda and Los Angeles sales tax rate to 10.25%.
- ➔ The average 2008 year-to-date retail price of a new car is \$26,421 (*Power Information Network*). Your 1.5% sale tax increase would increase consumer cost for the average new car by \$396 (*resulting in a whopping sales tax bill of \$2,708 in Los Angeles and Alameda counties*).

- Studies demonstrate that there is substantial price elasticity for vehicle sales and even a small price increase can be enough to significantly impact whether a consumer can afford to purchase a car or qualify for financing.
- The global credit crisis has dramatically affected the ability of consumers to obtain vehicle financing. According to the Federal Reserve, the volume of car loans declined 6% in the third quarter compared with the corresponding period last year. Average interest rates on car loans almost doubled from July to September -- the most recent month for which data is available -- and borrowers were required to make much larger down payments, an average of \$2,000 more down on a \$20,000 car. Increasing the sales tax will force consumers to make an even larger down payment – or skip buying at all.
- Your proposed sales tax increase will further depress new car sales and lead to a reduction, not an increase, in sales tax revenue generated from new car sales. In reviewing your proposal, the Legislative Analyst’s Office (LAO) noted that “This level of taxation would not only worsen the impacts on durable goods spending (particularly cars), but it would likely lead to increased internet and other “remote” purchases that could completely escape taxation.” (*LAO’s November 11, 2008 Overview of the Governor’s Special Session Proposals*).
- It has been estimated that a 1% increase in the sales tax would result in lost business investment of \$660 million and some 58,000 additional lost jobs (*Capitol Weekly, August 5, 2008 citing BOE study by Chief Economist Joe Fitz*).
- Sales tax is regressive, hitting hardest those who spend a relatively larger portion of their income on taxable goods and who have the least ability to pay.
- Price increases, however small, will discourage consumers from trading-in their older, high-polluting vehicles for newer, cleaner cars.

Expansion of Sales Tax to Automotive Repairs

- Every new car dealership in the state employs factory trained and certified automotive technicians and houses state-of-the-art diagnostic and repair equipment. Adding sales tax to labor charges for services performed by automotive technicians will result in fewer repairs and jeopardize the jobs and livelihood of those technicians. It will also lead to more dealership closures because those new car dealers who remain in business are weathering the economic storm on revenues generated in their service departments.
- Although your proposed sales tax increase is 1.5%, expanding sales tax to automotive repair services will result in an average statewide increase in repair costs of about 9.5% (the increase will be 10.25% in Los Angeles and Alameda counties). For a \$500 tune-up and brake job, the increase will be around \$50.
- Statewide unemployment is currently at 7.7% and consumer spending was down last month by 3.1% (the first monthly decline in over 20 years). California consumers are carefully watching every penny they spend. Our dealer members report that many service customers are already delaying recommended auto repairs, some of which affect safety and emissions. A 10% increase in the cost of automotive repairs will lead to fewer repairs. It will also lead to a delay or forbearance of preventative maintenance that will adversely affect California’s

efforts to increase fuel efficiency and reduce greenhouse gas and criteria pollutant emissions.

CNCDA's Position

No Sales Tax Increase. CNCDA opposes an increase in the sales tax.

No Expansion of Sales Tax to Automotive Repair. The sales tax should not be expanded to include automotive services.

Enact a Stimulus Package. In order to stimulate vehicle sales in California, we recommend that legislation be enacted to allow the value of a trade-in vehicle to be deducted from the purchase price of another vehicle for purposes of calculating sales tax. The vast majority of states already allow a sales tax offset for trade-ins. CNCDA urges careful consideration of this proposal for the following reasons:

- Permitting a deduction for the value of a trade-in vehicle when calculating sales tax on the purchase of a vehicle from a licensed dealer will stimulate vehicle sales and generate a *net* gain in sales tax revenue, even after the value of a trade-in is deducted.
- By 2010 approximately 5.8 million California vehicles will be at least 15 years old. These older vehicles represent about 25% of the vehicle fleet, but account for 75% of vehicle pollution. Accelerating fleet modernization by incentivizing consumers to trade-in older vehicles via sales tax incentives will stimulate new car sales, improve air quality, reduce global greenhouse gas emissions and enhance the effectiveness of the state's vehicle emissions programs by adding more low-emission vehicles to the on-road fleet.
- An increase in trade-ins will generate new sales tax revenue after those vehicles are refurbished and resold by dealers to the public. It is commonly known that many private-party used car transactions result in significant under-reporting and under-payment of sales tax because private party used car buyers often underreport the actual price they paid for a used car. Previously under-reported sales taxes would be captured through dealer transactions, resulting in an increase in sales tax revenues which should more than offset any losses from deducting the value of a trade-in with the purchase of a new car.
- Finally, encouraging consumers to trade in their used vehicles to licensed dealers, instead of selling them in private-party transactions, will ensure that each of those vehicles will have passed a safety and smog inspection prior to resale to another California consumer because licensed dealers are required to inspect and correct safety and emission problems prior to resale.

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Should you or your staff have any questions or comments, please do not hesitate to give me a call.

Very Truly Yours,



Peter K. Welch
President

cc: Susan Kennedy, Chief of Staff

The Honorable Karen Bass, Speaker of the State Assembly

The Honorable Don Perata, President pro Tem of the State Senate

The Honorable Darryl Steinberg, President pro Tem Elect of the State Senate

The Honorable Dave Cogdill, Senate Republican Leader

The Honorable Mike Villines, Assembly Republican Leader

The Honorable Denise Moreno Ducheny, Chair, Senate Budget &
Fiscal Review Committee

The Honorable Bob Dutton, Vice-Chair, Senate Budget & Fiscal Review Committee

The Honorable John Laird, Chair, Assembly Budget Committee

The Honorable Roger Niello, Vice-Chair, Assembly Budget Committee

The Honorable Noreen Evans, Chair Designee, Assembly Budget Committee
Ana Matosantos, Chief Deputy Director, Department of Finance