
SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
2025 - 2026 Regular

Bill No: SB 1275
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Version: 2/20/26
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Hearing Date: 4/8/26
Tax Levy: Yes
Fiscal: Yes

SALES AND USE TAX EXEMPTION: VEHICLE LICENSE FEE IMPOSITION: MOTOR VEHICLES

Enacts a State General Fund-only sales tax exemption for the purchase of a new motor vehicle, and in lieu imposes a new Vehicle License Fee in an amount equal to the exempted sales tax.

Background

Sales and use tax (SUT). State law imposes the sales tax on every retailer selling tangible personal property in this state. Retailers must register with the California Department of Tax and Fee Administration (CDTFA) and remit sales tax amounts collected at sale to CDTFA. If the purchaser does not pay the sales tax to the retailer, the purchaser is liable for paying use tax to CDTFA. The use tax is imposed on any person consuming tangible personal property in the state, and must be remitted on or before the last day of the month following the quarterly period in which the person made the purchase. The use tax rate is the same as the sales tax rate.

The table below shows the incremental structure of the sales and use tax at its current statewide rate of 7.25%. Additionally, cities and counties may increase the sales and use tax rate up to 2% with voter approval for specific or general purposes pursuant to the California Constitution's vote requirements.

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes
1.0625%	Local Revenue Fund (2011 Realignment)	Local governments to fund local public safety services
0.50%	State (1991 Realignment)	Local governments to fund health and welfare programs
0.50%	State (Proposition 172 - 1993)	Local governments to fund public safety services
1.25%	Local (City/County) 1.00% City and County 0.25% County	City and county general operations. Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

CDTFA collects sales taxes from retailers, deposits the state share in the General Fund, and then allocates the local share of the Bradley-Burns sales tax and any district tax to the appropriate jurisdiction.

Vehicle License Fees. The Legislature established the Vehicle License Free (VLF) in 1935 in lieu of a personal property tax on vehicles. Distinct from vehicle registration fees, the VLF is an *ad valorem* state tax levied on the purchase price of a vehicle and subsequently assessed annually against the vehicle's value, adjusted by a statutory depreciation schedule. Typically, vehicle owners pay the VLF to the Department of Motor Vehicles (DMV). Proposition 1A (2004) guarantees that revenue derived from the 0.65% VLF rate flows to cities and counties.

Motor vehicle purchasers pay the first year of VLF at the time of purchase as part of the original registration and titling process, along with other fees and charges. According to the DMV Fee Calculator, purchasing a new 2026 gasoline-powered vehicle on April 1, 2026, in the City of Sacramento for \$34,000 results in the following:

1. Sales tax: \$2,975
2. Current Registration: \$73
3. California Highway Patrol: \$34
4. Vehicle License Fee: \$222
5. Other Fees: \$166

State and local tax deduction. Federal law generally allows individuals to deduct specified state and local taxes (SALT) from taxable income as an itemized deduction in lieu of the standard deduction. Beginning in 2018, the Tax Cuts and Jobs Act (TCJA) changed several itemized deductions, including limiting the total deduction for SALT to \$10,000 (\$5,000 if married filing separately) for personal income taxpayers. Last year, Congress revised limits for forthcoming taxable years:

- \$40,000 for 2025.
- \$40,400 for 2026.
- For taxable years 2027 through taxable year 2029, the limit is increased by 1% each taxable year, with taxable year 2026 as the base year.
- For taxable year 2030 and after, \$10,000.

Congress also created a phasedown adjustment based on modified adjusted gross income (MAGI), which reduces the limit by 30% of the excess of the taxpayer's MAGI over the threshold amount (half the threshold amount in the case of a married couple filing separately). The threshold amount is \$500,000 for 2025 and 2026, and increases 1% annually until 2030.

Subject to the above limits, taxpayers can deduct state income taxes, as well as local real and personal property taxes, from federal taxable income. Taxpayers *can* deduct sales taxes; however, they can only do so when electing not to deduct income taxes, so few Californians deduct sales taxes because of the state's relatively high income tax rates.

As noted above, purchasers pay several fees and taxes when purchasing a new motor vehicle. While the VLF is deductible as a personal property tax, California taxpayers generally do not deduct sales taxes. The author wants to lower federal tax obligations for Californians purchasing new motor vehicles.

Proposed Law

Senate Bill 1275 enacts a State General Fund-only sales tax exemption for the purchase of a new motor vehicle, and in lieu imposes a new Vehicle License Fee in an amount equal to the exempted sales tax. The exemption and equivalent new VLF apply beginning on January 1, 2027, and end January 1, 2032.

The measure requires dealers to collect the license fee as a separate line item and remit the funds in the same manner as the current VLF. DMV must report amounts collected under the bill to CDTFA and deposit them in the General Fund on or before the last month following the close of a calendar quarter.

The bill also makes legislative findings and declarations to comply with Section 41 of the Revenue & Taxation Code.

State Revenue Impact

No estimate.

Comments

1. Purpose of the bill. According to the author, “California has the highest cost of living in the U.S., and Californians have one of the highest federal tax burdens in the nation. SB 1275 is innovative legislation that reduces Californians’ federal tax burden, while providing an incentive for motor vehicle sales. The bill eliminates the state sales tax on motor vehicles for five years and replaces it with a vehicle license fee of the same amount that can be deducted from federal taxes.”

2. Who benefits? SB 1275 enacts a creative mechanism to reduce federal taxes paid by Californians, while also providing an incentive to purchase a new vehicle. However, its beneficiaries may be limited to relatively higher-income taxpayers. Around 15% of California taxpayers itemize their federal taxes, with the rest claiming the standard deduction, which in 2025 is worth \$31,500 for married filing jointly filers, or \$15,750 for single or married filing separately. However, the share of new car buyers who itemize is likely higher. Additionally, those who pay more than \$40,000 in combined state and local taxes likely won’t benefit from SB 1275’s additional deductible VLF. However, for those who qualify, the benefits can be considerable. According to CDTFA, new-car dealers reported about \$85 billion in taxable sales in 2025, implying about 1.8 million new vehicles purchased in California annually at an average sales price of \$50,000. On a \$50,000 car purchase, the buyer currently pays \$2,000 in non-deductible State General Fund sales tax, which would be deductible from their federal income taxes under SB 1275. For a married filing jointly taxpayer who itemizes their federal taxes, this change would reduce their federal taxes by about \$500 that year. In aggregate, assuming 30% of new car buyers itemize, California taxpayers could reduce their federal taxable income by about \$1 billion per year and their federal taxes paid by about \$250 million per year.

3. Compliance. Car dealers must complete at least two procedures when selling a new motor vehicle. First, they must provide DMV with registration information for the purchaser, accompanied by payment of registration fees and the VLF, among other charges. Second, they must remit appropriate sales tax to CDTFA. As a result, SB 1275 would require new car dealers to change their accounting and payment systems, which could be costly and cumbersome.

Additionally, dealers would still remit local shares of the sales tax to CDTFA, because SB 1275 does not apply to those incremental rates. While many used car dealers must pay sales tax directly to DMV (AB 85, Committee on Budget, 2020), the change could be particularly troublesome for dealers that sell both used and new cars; these dealers would still remit all sales taxes on used cars to CDTFA, but would instead send SB 1275's equivalent VLF to DMV for new ones. The Committee may wish to consider amending SB 1275 to apply its provisions to used car dealers with more than 1,000 car sales in the current or preceding calendar year.

4. Implementation. Currently, CDTFA and DMV exchange information to ensure compliance with both the sales tax and the Vehicle Code. SB 1275 requires further reconciliation between the two agencies to ensure effective implementation, which could result in additional costs. Additionally, DMV is currently implementing the Digital eXperience Platform (DXP) project to update and replace software, hardware, and programming languages for its legacy systems. The Legislature appropriated \$193.5 million over a three-year period to implement several components of the project in the 2021 Budget, which was followed by \$60.3 million in the 2024 Budget Act. While the project is likely to be finished soon, any additional implementation costs could cause additional cost pressure on DMV, potentially affecting its ability to deliver services. According to the Legislative Analyst's Office (LAO), the Motor Vehicle Account (MVA), which is the primary funding source for DMV, has been experiencing a structural imbalance for many years, with expenditures consistently outpacing revenues. The state has been able to delay the account's insolvency through various budget adjustments, policy changes, and temporary transfers from other special funds. LAO argues that every new expenditure from the account—especially those that are comparatively large—should be well justified and clear a high bar for approval. In the Governor's 2026-27 Proposed Budget, the Governor warned that "the Budget currently projects that the MVA will be insolvent as soon as 2028-29. Given the ongoing fiscal constraints in the MVA, the Administration will continue to limit new workload or initiatives, including those with delayed implementation dates that would create additional cost pressures over time." The Committee may wish to consider amending SB 1275 to delay implementation to July 1, 2027, to ease implementation for DMV and CDTFA.

5. Two for the road. The Senate Rules Committee ordered a double referral of SB 1275, first to the Committee on Revenue & Taxation, and second to the Committee on Transportation.

6. Technical. Committee staff recommends amending SB 1275 to explicitly set the amount of its equivalent VLF, instead of referencing its sales tax exemption.

Support and Opposition (4/3/26)

Support: None received.

Opposition: None received.

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