
SENATE COMMITTEE ON APPROPRIATIONS

Senator Sabrina Cervantes, Chair
2025 - 2026 Regular Session

SB 1275 (McNerney) - Sales and use tax exemption: vehicle license fee imposition: motor vehicles

Version: April 9, 2026

Policy Vote: REV. & TAX. 4 - 0, TRANS.
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Urgency: No

Mandate: No

Hearing Date: May 4, 2026

Consultant: Robert Ingenito

Bill Summary: SB 1275 would (1) enact a state General Fund-only sales tax exemption for the purchase of specified vehicles, and (2) impose a new Vehicle License Fee (VLF) of an equivalent amount.

Fiscal Impact:

- The California Department of Tax and Fee Administration (CDTFA) estimates that this bill would reduce General Fund sales tax revenues by \$4.1 billion in 2027–28 and \$4.2 billion in 2028–29. However, this loss would be offset by the imposition of an additional VLF on each vehicle sold, with proceeds deposited into the General Fund and set equal to the amount of sales tax exempted. As a result, the combined effect of these two actions would be revenue neutral for the General Fund.
- The bill would result in reduced General Fund personal income tax revenue to the extent that taxpayers deduct the newly imposed VLF as a property tax on their state income returns. The magnitude is unknown, but could, at a minimum, reach the millions of dollars annually (see Staff Comments).
- Additionally, automobile purchasers who pay the higher first-year VLF and later have their vehicles declared a constructive total loss may be eligible to claim refunds of the unused portion of the fee, which would reduce General Fund revenues. The overall magnitude also is unknown, but could reach the millions of dollars annually (see Staff Comments).
- CDTFA's implementation costs would be minor and absorbable. The Department of Motor Vehicles (DMV) has not yet identified its administrative costs, but is likely to incur significant expenses due to the bill's impact on information technology and associated workload (Motor Vehicle Account).

Background: Except where a specific exemption or exclusion is provided, current law imposes SUT on all retailers for the privilege of selling tangible personal property (TPP) at retail in California, or on the storage, use, or other consumption in this state of TPP purchased from a retailer. Unless purchasers pay the sales tax to the retailer, they are liable for the use tax, which the law imposes on any person consuming tangible personal property in the state. The use tax is the same rate as the sales tax.

After CDTFA collects SUT revenue (\$79 billion in 2023-24), it allocates the money to various state and local funds. Roughly half—collected from an approximately 3.9 percent rate—goes to the General Fund and can be spent on any state program, such as education, health care, and criminal justice. Another 1.25 percent, known as the Bradley-Burns rate, goes to cities and counties for general purposes. Three sales tax funds have uniform state rates and support specified programs—a 1.0625 percent rate for 2011 realignment (county-administered criminal justice, mental health, and social service programs); a 0.5 percent rate for 1991 realignment (county-administered health and social services programs); and a 0.5 percent rate for city and county public safety programs pursuant to Proposition 172 (1993). Additionally, some local governments levy optional local rates—known as Transactions and Use Taxes (TUTs)—and a small portion of these funds are used for general purposes. As of December 31, 2025, the average statewide SUT rate was 8.84 percent.

Many items, such as prescription drugs, food, and poultry litter, are fully exempt from the SUT. Other items are exempted only from the state sales tax of 3.9375%, but not the local share, such as farm equipment and machinery, diesel fuel used for farming and food processing, teleproduction and postproduction equipment, timber harvesting equipment and machinery, and racehorse breeding stock.

The Legislature established the 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.

Current 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. Currently, the annual limits are (1) \$40,400 for 2026, (2) increases of one percentage point for taxable years 2027 through 2029, and (3) \$10,000 effective taxable year 3030. Congress also created a phasedown adjustment based on modified adjusted gross income (MAGI), which reduces the limit by 30 percent 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 percent 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. Consequently, few Californians deduct sales taxes because of the state's relatively high income tax rates.

Proposed Law: This bill, among other things, would do the following:

- Enact a General Fund-only (3.9375 percent) sales tax exemption for the purchase of a new or used motor vehicle sold by certain dealers or their affiliates, as specified, on or after July 1, 2027, and before July 1, 2032.
- Impose an additional VLF upon the first sale of a new motor vehicle or a used motor vehicle sold by certain dealers or their affiliates, as specified, on or after

July 1, 2027, and before July 1, 2032. The amount would be equal to the amount of exempted sales tax.

- Require the dealer to collect VLF as a separate line item, and remit the funds in the same manner as the existing VLF.
- Require DMV to report the amounts collected to CDTFA, as specified.

Staff Comments: This bill would likely not result in annual General Fund neutrality. While the sales tax reduction/offsetting VLF increase component would likely have a negligible combined impact, annual General Fund revenues under the bill would likely be lower relative to current law, for two reasons: (1) increased VLF deductions on state income tax returns, and (2) increased VLF refunds for automobiles that are totaled in their first year.

Increasing VLF deductions reduces taxable income, which in turn lowers a taxpayer's federal tax liability because a smaller portion of income is subject to federal income tax. At the same time, however, because California's income tax also allows deductions tied to VLF, the same increase can reduce state taxable income as well. The combined effect is a decrease in both federal and state income tax liabilities (and a corresponding reduction in General Fund revenue from the state personal income tax). The magnitude would depend on taxpayers' income levels, applicable tax rates, and whether they itemize deductions.

Under current state law, when a vehicle is declared a constructive total loss, the owner may be eligible for a partial refund of the VLF paid as part of the registration. The refund is generally prorated based on the unused portion of the registration period following the date the vehicle was totaled or permanently removed from use. To receive the refund, the owner must notify DMV and submit the appropriate documentation, such as proof of total loss from the insurer, and a request for cancellation of registration. Once processed, the State issues a refund for the remaining eligible portion of the fee. If VLF fees were to increase significantly (as they would under the bill), the amount eligible for refund would also rise proportionally, meaning that owners of totaled vehicles could receive larger refunds for the unused portion of their registration period. This would likely result in reduced General Fund revenue. As an order of magnitude, if 0.1 percent of purchased cars were declared a total loss in the first year, then potentially \$2 million could be refunded from the General Fund.

Currently, CDTFA and DMV exchange information to ensure compliance with both the sales tax and the Vehicle Code. This bill would require further coordination between the two agencies to ensure effective implementation, which could result in additional costs. Additionally, DMV is currently updating and replacing information technology software, hardware, and programming languages for its legacy systems. In the meantime, any additional implementation costs could cause additional cost pressure on DMV, the magnitude of which is still being determined. The MVA, which is the primary funding source for DMV, has been experiencing a structural imbalance for many years, with expenditures consistently outpacing revenues.

CDTFA would incur minor, absorbable administrative costs to update its website, revise publications, update the sales and use tax return, notify taxpayers, and respond to taxpayer and public inquiries.

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