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# SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair  
2025 - 2026 Regular

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<b>Bill No:</b>	SB 1406	<b>Hearing Date:</b>	5/6/26
<b>Author:</b>	McNerney	<b>Tax Levy:</b>	Yes
<b>Version:</b>	4/23/26 Amended	<b>Fiscal:</b>	Yes
<b>Consultant:</b>	Summers		

## ***SALES AND USE TAX LAW: VEHICLES: SHELL COMPANIES***

*Allows the California Department of Tax and Fee Administration to hold personally liable any officer, manager, partner, beneficial owner, or member of a shell company for any unpaid taxes on the purchase of a vehicle, vessel, or aircraft.*

### **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 the CDTFA. The use tax is imposed on any person consuming tangible personal property in the state. The use tax 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 that the current statewide SUT rate is 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.

<b>Rate</b>	<b>Jurisdiction</b>	<b>Purpose/Authority</b>
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% Local transportation	City and county general operations. Dedicated to county transportation purposes
<b>7.25%</b>	<b>Total Statewide Rate</b>	

**Vehicle sales and use tax.** When purchasing a vehicle from a dealer, the retailer collects sales tax at the point of sale. For a private-party sale, the buyer pays use tax to the California Department of Motor Vehicles when registering the vehicle within 30 days of the purchase.

Use tax is also due on all original registration and transfer applications for vehicles/vessels purchased from someone other than a licensed California dealer, manufacturer, or dismantler. When a California resident purchases a vehicle for use outside of California, the purchase may not be subject to use tax. However, there is a rebuttable presumption that when a vehicle purchased outside of California is first functionally used outside of California, and is brought into California within 12 months from the date of its purchase, the vehicle was purchased for use in California and is subject to use tax if any of the following occur:

- The vehicle is purchased by a California resident.
- The vehicle is subject to California DMV registration during the first 12 months of ownership.
- If purchased by a nonresident of California, the vehicle is used or stored in California more than one-half of the time during the first 12 months of ownership.

Additionally, a vehicle purchased out of state and brought into California during the first 12 months of ownership for the exclusive purpose of warranty or repair service is not presumed to have been purchased for use in California if the vehicle is used or stored in the state for that purpose for 30 days or less.

**The “Montana LLC Loophole”.** According to CDTFA, California loses approximately \$20 million in use tax revenue each year from the purchase of luxury vehicles, yachts, RVs, and aircraft due to a fraudulent tax scheme involving limited liability companies (LLCs) domiciled in Montana. To evade sales and use tax on their purchases, some California residents form a shell company LLC domiciled in Montana and buy the vehicle in the Montana LLC’s name, where they then take delivery of the vehicle outside the state and register the vehicle in Montana, where no sales or use tax applies, and subsequently return the vehicle to California within 12 months of purchase. Some California dealers may be complicit in this tax avoidance strategy, as they can lower the transaction cost and relieve themselves of any related sales tax liability by delivering the vehicle to the purchaser outside the state.

If the tax evader is identified, CDTFA can only impose and collect taxes for the vehicle on the shell company. However, because many shell companies are sham businesses with no assets, tax agencies cannot lawfully collect taxes without pursuing more aggressive, time-consuming collection methods, such as criminal and civil fraud allegations.

The author wants to strengthen California law by making it easier to collect taxes from tax evaders who create out-of-state shell companies to buy exotic luxury cars or expensive recreational vehicles in Montana or other states.

### **Proposed Law**

Senate Bill 1406 allows CDTFA to hold personally liable any officer, manager, partner, beneficial owner, or member of a shell company for any unpaid taxes on the purchase of a vehicle, vessel, or aircraft. The bill defines “shell company” as a closely held corporation, partnership, limited partnership, limited liability partnership, or limited liability company used for the purpose of evading the payment of taxes due under this part. Evidence that an entity is a shell company used for the purpose of evading the tax includes, but is not limited to, any of the following:

- It lacks a specific business activity or purpose.
- It fails to maintain a physical location outside California.
- It fails to employ individual persons and provide those persons with Internal Revenue Service Form W-2 wage and tax statements.
- It fails to file federal tax returns or fails to file a required state tax return in a state other than California.

This bill also expands the list of bona fide business types that are considered California “residents” when 50% of the business memberships’ interests are held by a California resident; specifies that a shell company shall be deemed to be a California “resident” if any shareholder, partner, member, or beneficial owner is a resident of California; and makes other technical amendments.

### **State Revenue Impact**

According to CDTFA, Senate Bill 1406 would increase sales and use tax and vehicle registration fee revenue by an unknown amount, and CDTFA’s implementation costs would be absorbable.

### **Comments**

1. **Purpose of the bill.** According to the author, “California loses approximately \$20 million in tax revenues a year due to the so-called ‘Montana Loophole,’ which enables California tax evaders to form out-of-state shell companies to purchase and register vehicles tax-free to avoid paying California taxes. SB 1406 would strengthen California law by making it easier to collect taxes from tax evaders that create an out-of-state shell companies to buy exotic luxury cars or expensive recreational vehicles in Montana or other states.”
2. **Department of Justice enforcement actions.** On March 6, 2026, the California Attorney General, together with the California Department of Motor Vehicles (DMV) and CDTFA, announced charges against 14 individuals for their alleged roles in a scheme to evade the reporting of over \$20 million in luxury vehicle purchases to avoid paying over \$1.8 million in California taxes.<sup>1</sup> The vehicles included a \$1.8 million McLaren Elva, a \$1.5 million Porsche 918 Spyder, and a \$1.26 million Ferrari F12TDF, among others. The individuals were charged in a 56-count complaint for criminal sales tax evasion, including conspiracy, filing false sales tax returns, failing to file tax returns, perjury, and money laundering. These charges were filed after a 2024 investigation by DMV, CDTFA, and the California Department of Justice revealed a scheme stretching back to 2018.
3. **Who benefits?** SB 1406 benefits Californians, the General Fund, and local governments that receive sales and use tax revenues. By deeming shell companies to be California residents when any owner is a California resident, and imposing personal liability on shell company members, the bill benefits compliant taxpayers and California vehicle dealers by holding tax evaders liable. It also benefits CDTFA enforcement efforts because the agency would no longer be limited to collecting from assetless shell companies.

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<sup>1</sup> [https://oag.ca.gov/system/files/attachments/press-docs/Complaint\\_Redacted\\_1.pdf](https://oag.ca.gov/system/files/attachments/press-docs/Complaint_Redacted_1.pdf)

**Support and Opposition** (5/1/26)

Support: California Teachers Association

Opposition: None received.

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