SENATE THIRD READING
SB 1406 (McNerney)
As Amended April 23, 2026
2/3 vote. Tax Levy

SUMMARY

Prevents the evasion of California sales and use tax (SUT) on purchases of vehicles, vessels, and aircraft made by a "shell company", as defined, that is domiciled in another state.

Major Provisions

1) Provides that a partnership, limited partnership (LP), or limited liability partnership (LLP) is a resident of the state if 50% of the entity's interests are held by partners that are residents of the state.

2) Provides that a "shell company" is a resident of the state if a shareholder, partner, member, or beneficial owner is a resident of the state; requires such an individual be personally liable for unpaid taxes, interest, and penalties due on a vehicle, vessel, or aircraft, the nonpayment of which may constitute a crime; and provides how the Department of Tax and Fee Administration (CDTFA) may establish and collect on the liability.

3) Defines a "shell company" as a closely held corporation, partnership, LP, LLP, or limited liability corporation (LLC) used to evade the payment of use tax and provides the evidentiary factors used to make such a determination, such as the entity's lack of a specific business activity or purpose.

COMMENTS

1) *Purchasing vehicles and vessels*: When a vehicle or vessel is purchased from a person who is engaged in business in California as a vehicle or vessel dealer, that person is responsible for registering with the CDTFA and collecting, reporting, and paying applicable sales tax. When a vehicle or vessel is bought from a person who is not a California dealer, including a private party selling a used vehicle, the purchaser is generally required to pay use tax for the use of the property in California unless an exception applies. Common exceptions where use tax does not apply include vehicles received as gifts, purchases from certain family members, and vehicles purchased or delivered out-of-state and are not used or stored in California.

   The use tax is based on the total purchase price of the vehicle or vessel. The total purchase price includes cash, the payment or assumption of a loan or debt, and the fair market value of any property and/or services traded or exchanged for the vehicle or vessel. The tax rate for use tax is the same as that for sales tax and it is determined by the address where the vehicle is registered with the Department of Motor Vehicles (DMV) or the vessel is moored.

2) *Montana Tax Evasion Scheme*: According to the CDTFA, California loses approximately $20 million in use tax revenues each year from the purchase of luxury vehicles, yachts, RVs, and aircraft due to a well-known tax loophole involving LLCs domiciled in Montana. To avoid tax on their California purchases, some Californians form a "shell company" domiciled in Montana (Montana LLC) and buy the vehicle in the Montana LLC's name. Subsequently, they take delivery outside the state and register the vehicle in Montana, where no sales or use tax applies, and return the vehicle to California for use or storage within 12 months following

purchase. This allows them to avoid any taxes on the purchase, including California use tax and vehicle registration fees. Some California dealers may be complicit in this tax avoidance strategy as they can lower the cost of the transaction and relieve themselves of any related sales tax liability by delivering the vehicle to the purchaser outside the state.

Once a tax evader is identified, CDTFA may not hold the individual personally liable for the taxes owed by their LLC. The Montana LLC is generally a "shell company" with no assets other than the vehicle for which there is no record of registration in California. Accordingly, recovering the tax from a Montana LLC is extremely difficult.

The Montana LLC loophole is popular due to its simplicity. In just a few hours, any person may easily form a Montana LLC online through a Montana registered agent, avoiding thousands of dollars in California use tax. Entity formation services can promise quick registration in a state with no sales tax, transporters can produce fake shipping paperwork listing out-of-state delivery addresses, and storage facilities can hold vehicles long enough to create the appearance of compliance.

For example, a Bloomberg Tax investigation found:

> Kalispell-based 1 Dollar Montana LLC boasts that it can provide license plates and registration documents to clients in two weeks. Neither the purchaser nor the vehicle need to be in Montana to close the deal. The cost depends on the services, but 1 Dollar Montana says it's willing to handle the job for as little as $1,049. Dirt Legal, a Florida-based agent with a broad social media footprint, says it has formed Montana LLCs for nearly 47,000 customers, with clients in every state…
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> There is no distinct database tracking the number of vehicles owned by Montana LLCs. However, Montana's 2.68 vehicles per licensed driver suggests thousands of out-of-staters are driving with Montana plates. Former Montana revenue director Dan Bucks said there are likely more than 600,000 vehicles registered in Montana but operated in other states.

3) *Recent enforcement operation*: In March of this year, California recovered $4 million in unpaid taxes and fees from thousands of car owners and dealers. Attorney General Rob Bonta, working with the CDTFA and DMV, brought criminal charges against 14 people as part of a crackdown on luxury vehicles plated in Montana to evade state taxes and registration costs. The 57-count complaint, filed by the California Department of Justice on February 23 in the Sacramento County Superior Court, accuses the defendants of conspiracy to commit tax evasion, filing false sales tax returns, money laundering, and perjury. The defendants arranged vehicle sales valued at $18.8 million, resulting in $1.6 million in unpaid taxes.

According to the Author

The Montana Loophole costs California up to $20 million a year in lost revenue and the loophole is widening, with increasing numbers of tax evaders creating phony shell companies so they can avoid paying sales taxes on Ferraris, Porsches and pricey RVs.

SB 1406 would strengthen California law by making it easier to collect taxes from tax evaders that create shell companies to buy exotic luxury cars or expensive recreational vehicles in Montana or other states.

Arguments in Support
This bill is supported by SEIU California, which notes, in part:

> This bill would strengthen California law by making it easier to collect taxes from tax evaders that create an out-of-state shell company to buy exotic luxury cars or expensive recreational vehicles in Montana or other states.
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> Due to the so-called "Montana Tax Loophole," California loses approximately $20 million in tax revenue annually. Tax loopholes like these reduce the amount of revenue the state collects and hurts working people and their families, like the ones SEIU represents. It is fundamentally unfair for California residents to pay taxes when others use shell companies to avoid them.

Arguments in Opposition
The Capitol Business Alliance, writing in opposition to this bill unless it is amended, notes, in part:

> Our greatest concern is the personal-liability provision. SB 1406 would expose officers, managers, partners, beneficial owners, and members of an alleged shell company to unpaid tax, interest, and penalties. That is a significant expansion of personal liability and could undermine ordinary limited-liability protections. Passive owners, minority members, family participants, and beneficial owners should not face personal liability unless they actually controlled, authorized, participated in, or knowingly benefited from the transaction at issue.
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> California can close abusive loopholes without creating uncertainty for legitimate entrepreneurs. Small-business entities should not have to fear that ordinary operational facts--such as having no W-2 employees or no out-of-state office--could later be characterized as evidence of tax evasion.

FISCAL COMMENTS

According to the Assembly Committee on Appropriations:

1) Annual General Fund (GF) and vehicle registration fee revenue gain of an unknown, but likely significant amount, in excess of $150,000, by creating a means to collect use tax and fees legally owed, but unremitted.

2) Absorbable ongoing costs to CDTFA for enhanced enforcement and collection activities and likely similar ongoing costs to DMV to assist CDTFA with disputes and investigation of cases. Minor one-time costs to DMV to update forms, publications, and industry memos.

3) By making additional individuals liable for use tax payments under the SUT Law, the nonpayment of which may be a misdemeanor or felony depending on the nature of the violation, ongoing cost pressures of an unknown amount to the courts to adjudicate a criminal charge (GF or Trial Court Trust Fund (TCTF)) and costs to the Department of Corrections and Rehabilitation or cost pressures to the counties of an unknown amount to incarcerate a convicted individual (GF).

VOTES

SENATE FLOOR: 31-8-1
YES: Allen, Archuleta, Arreguín, Ashby, Becker, Blakespear, Cabaldon, Caballero, Cervantes, Choi, Cortese, Durazo, Gonzalez, Grayson, Hurtado, Laird, Limón, McGuire, McNerney, Menjivar, Padilla, Pérez, Reyes, Richardson, Rubio, Smallwood-Cuevas, Stern, Umberg, Wahab, Weber Pierson, Wiener
NO: Alvarado-Gil, Dahle, Grove, Jones, Ochoa Bogh, Seyarto, Strickland, Valladares
ABS, ABST OR NV: Niello

ASM REVENUE AND TAXATION: 5-2-0
YES: Gipson, Carrillo, McKinnor, Quirk-Silva, Michelle Rodriguez
NO: Sanchez, DeMaio

ASM APPROPRIATIONS: 11-4-0
YES: Wicks, Arambula, Calderon, Caloza, Fong, Mark González, Krell, Pacheco, Pellerin, Sharp-Collins, Solache
NO: Hoover, Dixon, Ta, Tangipa

UPDATED

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