

Be Careful With High End Cars and Taxes

By Robert W. Wood

Cars and taxes may sound like an unusual pairing, but as anyone who has bought a new car in recent years may know, the taxes can add up. Car prices in the old days often seemed to be phrased as \$____, “plus tax and license” or “\$__ out the door.” Some dealers may offer a special promotions where *they* pay the sales tax. But the state gets the tax money either way, from you or the dealer. Taxes seem to go with just about everything one way or another.

There are income taxes, property taxes, sales and use taxes, and even excise taxes like the federal gas tax. If you’ve gone to the gas pump recently you may notice the signs that admonish how expensive gas is, in California in particular. Most of us think first and foremost about federal taxes. Apart from the federal gas tax, there is the so-called gas guzzler tax on new passenger cars that fail to meet minimum fuel economy standards.

In California, state taxes on just about everything add up quickly, and can be a major motivator for some people to move away. Witness the recent hype—and moves—over the proposed billionaire’s tax. Even without a physical move from the Golden State, many people try to arrange their affairs so they pay a little less in tax.

For example, for years, it was common for well-healed Californians to set up trusts with out-of-state trustees. Prime locations were South Dakota, Nevada, Wyoming, and other no-tax states. The usual grantor trust that you might form for estate planning purposes doesn’t help, since the grantor must include the income on his return. But these special trusts were set up so that the grantor was not technically the owner, so the income wasn’t taxable in California.

For years, California’s Franchise Tax Board said it was studying the issue, and the assumption by many was that the issue would be litigated. But then, starting in 2023, California’s tax law was changed to make the income taxable in California after all. California is famously aggressive in its tax collection efforts. The state also has very sky-high tax rates, so it is perhaps not surprising that some people try out-of-state tax moves to skirt California taxes more than they might if the rates were more modest.

But does California ever take a page out of the IRS playbook and pursue criminal tax charges? Only rarely, as it turns out, and many of those criminal tax cases involve additional criminal charges beyond tax matters. Not everything is about income taxes. Take the seemingly mundane subject of sales tax and registration fees on a new car.

California law allows residents to save on taxes if the vehicle is delivered, used, and stored out of state for at least 12 months. But are some people claiming this sizable tax benefit--say on a very expensive new car--but skirting the rules? You guessed it, and now, the California Department of Tax and Fee Administration (a key California tax agency with the ungainly acronym CDTFA) and the California DMV are cracking down on car dealers who facilitate tax evasion by enabling their customers to use the so-called “Montana Loophole.”

California tax authorities say this scheme involves buyers creating an out-of-state limited liability company that registers their high-end car in hopes of avoiding paying California taxes and registration fees. The Golden State’s DMV and CDTFA are examining all sales made to Montana purchasers, not just those involving LLCs. CDTFA has identified close to 500 California dealers involved in more than 2,500 sales since 2023 to customers claiming to use the vehicle in Montana.

Setting up LLCs in Montana is a breeze, in part due to the fact that there are many registered agents that help out-of-staters take advantage of Montana’s lenient tax and registration rules. Some agents offer to manage title, registration, and license plate issues for modest fees.

Authorities say many of these cases involve luxury or exotic cars, and that they are costing the state more than \$10 million a year in lost tax revenue. The top cities for violators? You guessed it, Beverly Hills, but there are many other southern California cities, and Mill Valley in Marin County. Such centers of high incomes and big spenders on luxury and exotic cars are in the headlights, so to speak. California has opened more than 400 investigations into high-end automobile purchasers, plus begun nearly 300 audits of dealers related to vehicle sales to no-tax states, including Montana.

Sales tax in the year of sale may be the biggest single item, but authorities say lost annual vehicle registration fees add up quickly with each passing year. California is trying to scoop up revenue lost due to fraudulent registrations, and its not just Montana either. Other states include Alaska, Delaware, New Hampshire, and Oregon.

The penalties for Californians fraudulently registering a car out of state and claiming it is being used outside California include a 50% penalty on top of the tax on the purchase price. But more may be involved than a penalty or fine. The state has pursued 81 criminal investigations since June 2023 over more than 600 fraudulently registered vehicles. In some cases, the state filed criminal charges, assessing penalties and collecting past-due registration fees.

Under state law, residents must pay California sales tax on vehicles that are not first used and kept out of state for at least 12 months. Dealers must keep records to make sure vehicles sold to buyers in another state are delivered there. At the end of 2024, California sent warning letters to California auto dealers cautioning that they could be liable for taxes if they fail to keep proper shipping and delivery records. The state lists more rules in its tax guide for motor vehicle dealers.

California’s latest move is a 57-count complaint filed in Superior Court for Sacramento County that accuses the named defendants of conspiracy to commit tax evasion, filing false sales tax returns, money laundering, and perjury.

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