

**BOARD OF EQUALIZATION****BUSINESS TAXES COMMITTEE MEETING MINUTES**

HONORABLE JOHN CHIANG, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: AUGUST 6, 2003, TIME: 9:30 A.M.

ACTION ITEMS & STATUS REPORT ITEMS**Agenda Item No: 1**

Title: Proposed Revisions to Audit Manual Chapter 4, *General Audit Procedures*, Regarding Property Held for Resale, when the Property is Transferred from an Inventory Account to a Capital Asset Account and Depreciated (Continued from the 5-28-03 BTC Meeting)

Issue/Topic:

Should tax apply to the cost of tangible personal property used for demonstration and display when the property is transferred from a resale inventory account to a fixed asset account and depreciated?

Committee Discussion:

Action 1 – Capitalization and Depreciation of Resale Property Used for Demonstration and Display, while Holding it for Sale in the Regular Course of Business

Some interested parties addressed the Committee, expressing their support for the language proposed in Alternative 1. They stated the alternative covers the needs of staff and taxpayers and allows flexibility in audit situations.

An interested party addressed the Committee in support of Alternative 3, stressing the importance of a bright line test. The speaker expressed the concern that approval of either Alternative 1 or 2 would result in a large revenue loss.

Following a Committee member question, a discussion ensued regarding the records that would suffice for the needs of the taxpaying community and the Department staff in Alternatives 1 and 2. Staff expressed the need to have records maintained showing the status of each depreciated item through final disposition. Interested parties responded stating that records are normally available by category rather than for each individual item.

Action 2 – Approval to Publish

There was no discussion of this item.

Committee Action/Recommendation/Direction:Action 1 – Capitalization and Depreciation of Resale Property Used for Demonstration and Display, while Holding it for Sale in the Regular Course of Business

The Committee approved the language proposed in Alternative 1.

Action 2 – Approval to Publish

The Committee recommended that the Board approve publication of the proposed revisions to Audit Manual Chapter 4 as adopted in the above action. Implementation will take place upon Board approval. A copy of the new Audit Manual section is attached.

Agenda Item No: 2**Title: Proposed Regulation Regarding Application of Tax to Rebates and Incentives (Proposed Regulation 1671.1, *Discounts, Coupons, Rebates and Other Incentives*)****Issue/Topic:**

Should proposed Regulation 1671.1, *Discounts, Coupons, Rebates and Other Incentives*, be published to clarify the application of tax to discounts, coupons, rebates and other incentives?

Committee Discussion:Action 1 – Agreed Upon Items

There was no discussion of this item.

Action 2 – Application of Tax to Buy-Down Rebate Revenues

Several interested parties expressed their opposition to staff's recommendation due to concerns regarding the two and three-party distinction (cost of goods sold adjustments vs. gross receipts), the need for customer knowledge, and the validity of the revenue impact of the interested parties' proposal.

One interested party expressed a concern that neither staff's nor industry's proposed regulation addresses the application of tax to mail-in rebates. The interested party stated that the application of tax to mail-in rebates should be treated the same as manufacturer coupons and instant rebates.

A few interested parties expressed their support for staff's recommendation due to concerns regarding the distinction between two-party and three-party transactions that retailers should be required to pay tax on the full consideration received, that customer knowledge is irrelevant, and that the revenue impact of the interested parties' proposal would significantly affect the State.

Action 3 – Incorporating the Application of Tax to Discounts and Payments Offered Through Grocery Store Discount Club Cards and Other Clarifying Language

There was no discussion of this item.

Business Taxes Committee – August 6, 2003
Agenda Item 1 – Proposed Revisions to Audit Manual Chapter 4

**Action 1 - Capitalization and Depreciation of Resale Property Used for
Demonstration and Display, while Holding it for Sale in the Regular Course
of Business**

As Recommended by the Business Taxes Committee

PURCHASES SUBJECT TO SALES OR USE TAX 0408.00

CAPITALIZATION OF RESALE INVENTORY 0408.28

Note: This section does not apply to the capitalization and depreciation of a vehicle. The application of tax to the demonstration and display of vehicles is covered in Regulation 1669.5.

There is a strong presumption that resale merchandise withdrawn from an inventory account, including property used for demonstration and display, capitalized in a fixed asset account and depreciated for income tax purposes is not held for sale in the regular course of business. To overcome this presumption, the taxpayer must provide documentation suitable to the Department that the property has been used solely for exempt demonstration and display purposes while holding it for sale in the regular course of business. In the absence of such evidence, resale merchandise withdrawn from an inventory account, capitalized in a fixed asset account and depreciated for income tax purposes shall be included in the schedule of unreported property subject to tax.