State of California

Board of Equalization
Sales and Use Tax Department
Special Taxes and Fees Department

Memorandum

To : Ms. Cynthia Bridges
Executive Director (MIC 73)

Date: October 6, 2015

Lynn Bartolo

From : Lynn Bartolo, Acting Deputy Director
Sales and Use Tax Department (MIC 43)

Subject : Board Meeting October 27, 2015
Item N: Administrative Agenda
Proposed Revisions to Audit Manual Chapter 4, *General Audit Procedures* and Chapter 12, *Construction Contractors*

I am requesting approval to forward the attached revisions to Audit Manual (AM) Chapter 4, *General Audit Procedures,* and Chapter 12, *Construction Contractors,* to the Board Proceedings Division to be placed as a consent item on the Administrative Agenda at the October 2015 meeting.

The proposed revisions add the following new sections to AM Chapters 4 and 12, to incorporate current audit policies and management guidelines:

Section 0422.00	Partial Exemptions
• Section 0422.10	Farm Equipment and Machinery
• Section 0422.15	Solar Power Facility
• Section 0422.20	Contract Operators Diesel Fuel Partial Exemption
Section 1208.60	Construction Contractors Purchasing Qualified Farm Equipment and Machinery

The proposed revisions have been reviewed and approved by SUTD management, provided to Board Members, and posted on the Board's website at http://www.boe.ca.gov/sutax/pmr.htm to solicit comments from interested parties. No comments were received from Board Members or other interested parties.

If you have any questions, please let me know or contact Ms. Susanne Buehler at 324-1825.

LB:ljm
Attachment

Approved:

Cynthia Bridges

Ms. Cynthia Bridges
Executive Director

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the October 27, 2015 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

cc: (all with attachment)
Mr. David Gau (MIC 101)
Mr. Wayne Mashihara (MIC 47)
Ms. Susanne Buehler (MIC 92)
Ms. Lynn Bartolo (MIC 57)
Mr. Richard Parrott (MIC 88)
Mr. Kevin Hanks (MIC 49)
Mr. John Thiella (MIC 73)
Mr. Marc Alviso (MIC 101)
Mr. Chris Lee (MIC 101)
Ms. Leila Hellmuth (MIC 43)

PARTIAL EXEMPTIONS 0422.00

FARM EQUIPMENT AND MACHINERY 0422.10

Revenue and Taxation Code section 6356.5 (see also Regulation 1533.1, *Farm Equipment and Machinery)*, provides a partial sales and use tax exemption for the sale or purchase of farm equipment and machinery purchased for use by a qualified person to be used primarily in producing and harvesting agricultural products. See the regulation for specific definitions. For example, the following terms (and others) are found in the regulation: "farm equipment and machinery," "qualified person," "primarily," and "producing and harvesting agricultural products."

A qualified person who purchases or leases qualified property from an in-state retailer or an out-of-state retailer obligated to collect the use tax, must provide the retailer with a partial exemption certificate in order for the retailer to claim the partial exemption. If a retailer takes a partial exemption certificate timely and in good faith from a purchaser, the retailer is relieved from the liability for the sales tax subject to the partial exemption or the duty of collecting the use tax subject to the partial exemption under the regulation. A seller is presumed to have taken a partial exemption certificate in good faith in the absence of evidence to the contrary. If the purchaser does not qualify for the partial exemption or the property is not used in a qualifying manner, the purchaser is liable for the tax, with applicable interest, to the same extent as if the purchaser were a retailer making a retail sale of the property at the time the property was purchased.

In an audit of the seller, if the auditor believes the transaction does not qualify for the partial tax exemption and the seller has accepted a partial exemption certificate timely and in good faith, a BOE-1164, *Audit Memorandum of Possible Tax Liability*, should be issued and sent to the district of the purchaser.

For example, if the purchaser provides a partial exemption certificate to the retailer and then uses that property in a manner not qualifying for the partial exemption, or the purchaser is not a qualified person, as discussed above, the purchaser is liable for payment of the sales tax.

SOLAR POWER FACILITY 0422.15

The purchase of a solar power facility may qualify for the farm equipment and machinery partial exemption in Revenue and Taxation Code (RTC) section 6356.5. (See also Regulation 1533.1, *Farm Equipment and Machinery*). To qualify for the partial exemption, there must be:

(1) A qualified person that
(2) Purchases qualifying farm equipment and machinery and
(3) Uses that equipment and machinery primarily in producing and harvesting agricultural products.

All three of these requirements must be met in order for the purchase to qualify for the partial exemption.

Solar Power Facility Directly Attached to Farm Equipment and Machinery

When a solar power facility is directly attached to, and primarily provides power to (i.e., operates), qualifying farm equipment and machinery, the solar power facility generally qualifies as "farm equipment and machinery." As such, the purchase of such a solar power facility generally qualifies for the partial exemption as long as the other requirements for the partial exemption are met.

Solar Power Facility Not Directly Attached to Farm Equipment and Machinery

A solar power facility may qualify as "farm equipment and machinery" when the solar power facility is not directly attached to qualifying farm equipment and machinery but is instead tied to the regional power grid and subject to a net metering agreement between the taxpayer and the electric cooperative. In such cases, the taxpayer needs to demonstrate that the solar facility is specifically purchased to provide power to (i.e., operate) qualifying farm equipment and machinery.

Factors to consider when determining if a solar power facility was specifically purchased to provide power to qualifying farm equipment and machinery include, but are not limited to:

- The basis for the design and size of the solar power facility (e.g., a study or calculation),
- The amount of power the solar power facility produces,
- The electrical power needs of the qualifying farm equipment and machinery, and
- Whether the electric cooperative required that the solar power facility be tied to the regional power grid.

When determining whether the solar power facility is primarily used in producing and harvesting agricultural products, 50 percent or more of the annual energy generated by the solar power facility needs to be consumed by the qualifying farm equipment and machinery in producing and harvesting agricultural products. This may be calculated by using the following formula:

> Total annual amount of power consumed by the qualifying farm equipment and machinery in producing and harvesting agricultural products ÷ the total annual amount of power generated by the solar power facility.

The taxpayer must provide evidence to demonstrate that the solar power facility is primarily used in producing and harvesting agricultural products. Evidence includes, but is not limited to, data from meters on the qualifying farm equipment and machinery as well as documentation of the number of pieces of qualifying farm equipment and machinery, the number of hours the qualifying farm equipment and machinery operate, and the amount of power consumed by the qualifying farm equipment and machinery per hour.

Please see Regulation 1533.1 for more information.

Construction Contracts

A solar facility may be furnished and installed by a construction contractor pursuant to a construction contract. To the extent the construction contractor is regarded as a retailer under Regulation 1521, *Construction Contractors*, the farm equipment and machinery partial exemption applies to the sale of such items to the qualified person so long as all of the requirements of RTC 6356.5 are met. On the other hand, to the extent the construction contractor is regarded as the consumer under Regulation 1521, the partial exemption does not apply to the construction contractor's purchases of materials for use in constructing the solar facility.

See AM Chapter 12, *Construction Contractors*, for additional information.

CONTRACT OPERATORS
DIESEL FUEL PARTIAL EXEMPTION 0422.20

Revenue and Taxation Code section 6357.1 (See also Regulation 1533.2, *Diesel Fuel Used in Farming Activities or Food Processing)*, provides a partial sales and use tax exemption for the sale, storage, use, or other consumption of diesel fuel used in farming activities or food processing. The terms "farming activities" and "food processing" are defined in Regulation 1533.2. The sale of diesel fuel to persons who conduct farming activities for farmers and ranchers on a contract basis (contract operators) qualifies for the partial sales and use tax exemption, provided the purchaser provides a timely and complete partial exemption certificate to the fuel vendor.

A contract operator is considered to be a person hired by a commercial farmer or rancher to perform farming activities in support of the raising or harvesting of any agricultural or horticultural commodity that may be legally sold or offered for sale to others. For plant products, "farming activities" include, but are not limited to, preparation of land for planting, including ripping, leveling, plowing, disking, harrowing and furrowing; seeding and planting; irrigating; spraying of herbicide or pesticides; pruning; and harvesting. For animal products, "farming activities" include, but are not limited to, herding, hauling, raising, shearing, feeding, caring for, training, and management of animals. "Farming activities" do not include activities peripheral to the actual raising and harvesting of agricultural products, such as the construction, repair or refurbishing of farming or ranching facilities or equipment.

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CONSTRUCTION CONTRACTORS PURCHASING QUALIFIED FARM EQUIPMENT AND MACHINERY 1208.60

Revenue and Taxation Code section 6356.5 (See also Regulation 1533.1, *Farm Equipment and Machinery*), provides a partial exemption for the sale of qualifying farm equipment and machinery to qualified persons for use primarily in producing and harvesting agricultural products. A qualified person who purchases or leases qualifying property from a California retailer, or registered out-of-state retailer required to collect use tax, must provide the retailer with a partial exemption certificate in order to claim the partial exemption. To be relieved from the liability for sales tax subject to the partial exemption or the duty of collecting use tax subject to the partial exemption, the retailer must timely, and in good faith, accept a partial exemption certificate from the qualified person. The retailer must maintain the partial exemption certificate in his or her records.

Construction contractors are generally *not* regarded as qualified persons as defined in Regulation 1533.1. Regulation 1521, *Construction Contractors*, specifies that construction contractors are regarded as retailers of fixtures, machinery and equipment and other tangible personal property which they furnish and install in the performance of a construction contract. Under certain circumstances, a construction contractor may also be the retailer of materials they furnish and install. As retailers, construction contractors are required to maintain a seller's permit. A construction contractor holding a valid seller's permit may issue a proper resale certificate to purchase fixtures, machinery and equipment, and other tangible personal property including qualifying farm equipment and machinery, for resale to a qualified person. As a retailer, a construction contractor must timely, and in good faith, accept a partial exemption certificate from the qualified person in order to be relieved from the liability of tax subject to the partial exemption.

California retailers, and registered out-of-state retailers required to collect use tax, may not accept a partial exemption certificate from a construction contractor for purchases of qualifying farm equipment and machinery for resale to a qualified person. Retailers may only accept partial exemption certificates from qualified persons purchasing qualifying property. However, retailers may timely accept a valid *resale certificate* in good faith from a construction contractor holding a seller's permit who purchases qualifying farm equipment and machinery, or any other property, for resale. In such a case, the sale by the retailer to the construction contractor would be non-taxable.

In an audit of a retailer selling qualified farm equipment and machinery, staff should accept claimed sales for resale made to construction contractors, who purchase qualifying farm machinery and equipment that will be incorporated into the real property, when the retailer timely takes, in good faith, a valid resale certificate from the construction contractors. In absence of evidence to the contrary, staff should accept such resale certificates as having been taken in good faith by the retailer. See Regulation 1668, *Sales for Resale*, subdivision (c).

See AM section 0422.15, *Solar Power Facility*, for information on construction contracts of solar power facilities that may qualify for the farm equipment and machinery partial exemption as provided in Regulation 1533.1.