

Memorandum

To : Mr. David Gau
Chief Deputy Director (MIC 101)

Date: March 8, 2016

From : Lynn Bartolo, Acting Deputy Director
Business Tax and Fee Department (MIC 43)



Subject : **Board Meeting March 29-30, 2016**
Item N: Administrative Agenda
Proposed Revisions to Compliance Policy and Procedures Manual (CPPM)
Chapters 2, 7, and 8

I am requesting approval to forward the attached revisions to the Board Proceedings Division to be placed as consent items on the Administrative Agenda at the March 2016 meeting. The following sections are being revised to incorporate current policies and procedures:

- Chapter 2, Section 230.070, *IRIS Lead Source*
- Chapter 7, Section 708.020, *The Delinquency Process*
- Chapter 7, Section 740.210, *Partners in Bankruptcy*
- Chapter 8, Section 820.091, *Farm Equipment and Machinery*

These revisions have been reviewed and approved by Business Tax and Fee Department 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 (916) 324-1825.

LB:rs

Attachment

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the March 30, 2016 Board Meeting

Joann Richmond
Joann Richmond, Chief
Board Proceedings Division



Approved



Mr. David Gau
Chief Deputy Director

cc: (all with attachment)

Mr. Wayne Mashihara (MIC 47)

Ms. Susanne Buehler (MIC 92)

Mr. Richard Parrott (MIC 57)

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)

IRIS LEAD SOURCE

230.070

The Lead Source Subsystem was developed to track the results of various special programs and pilot projects undertaken by the BOE. The Lead Source Subsystem is comprised of Lead Source and Lead Source Sub-types that enable the BOE to capture and identify revenue and payments resulting from a specific program or project. This is accomplished by attaching a Lead Source and Lead Source Sub-type to an account or a Financial Obligation (FO) in IRIS. By doing so, reports reflecting revenue and payment information related to a specific program or project can be generated.

The Lead Source and Lead Source Sub-type should be assigned to accounts or liabilities established from the results of efforts of a special program or project team ("responsible team"), for example, Statewide Compliance and Outreach Program (SCOP), U.S. Customs group, or Special Taxes project teams.

Lead Source and Lead Source Sub-type **should** be assigned:

- To an account, when a new permit is issued that will result in previously unreported revenue being reported to the BOE.
- To an audit, field billing order, or other FO, generated as a result of the development of the lead by a responsible team and used to determine a liability or offset a payment.

Lead Source and Lead Source Sub-type **should not** be assigned:

- To a new permit issued to correct an ownership or other situation for a business, in which revenue was routinely being reported.
- To an FO selected and assigned for audit through the annual audit selection process. However, lead information relating to an account selected and assigned for audit should be forwarded to the auditor conducting the audit.

Lead Source and Lead Source Sub-type for Audits:

- If a lead exists for an account that has been selected for audit, but still unassigned, the responsible team should contact the district or controlling unit of the account to determine whether the account will be assigned. If the audit is not assigned, the lead should be referred to the District Administrator requesting a review of the lead information. If the account is assigned as a result of the responsible team lead information, then the lead source information should be assigned to the audit FO. However, if an account was already assigned, the lead information should be forwarded to the auditor **without** a request to assign the lead source information to the audit FO.
- If a lead exists for an account that has not been selected for audit, the responsible team should refer the lead to the District Administrator with a request that if the account is assigned for an audit as a result of the lead information, then the responsible team lead source information should be assigned to the audit FO.

To assign a Lead Source and Lead Source Sub-type:

- Lead Source and Lead Source Sub-type can be assigned to an account or FO by accessing the *Maintain/Inquire Lead Source Information* screen (LSR ML) in IRIS. When assigning Lead Source and Lead Source Sub-type information for a new account, it is important to use an accurate Report Start Date and Report End Date.

- The Report Start Date is the date that revenue and payment information, posted to a new account, becomes eligible for inclusion in revenue and payment reports. Unless instructed otherwise, it should be the same date as the account creation date. Using a Report Start Date that is after the account creation date will result in delinquent return information and payments being excluded from the revenue and payment reports.
- The Report End Date is the date for which revenue posted to the new account is no longer eligible for inclusion in the revenue and payment reports. Since special programs and pilot projects typically have a two year evaluation cycle, the Report End Date should always be two years after the Report Start Date, unless instructed otherwise.
- The Report Start Date for a **closed out and reinstated** account is the date the account was reinstated (re-opened).

Note: Report Start and Report End dates are not needed when assigning Lead Source and Lead Source Sub-type information to a specific FO, since the FO will always be included as revenue.

Responsibilities:

- All Lead Source referrals to the district or Headquarters (HQ) program area should clearly state which Lead Source and Lead Source Sub-type should be assigned.
- It is the responsibility of the district or HQ program area that receives the application or referral for audit from the responsible team, to timely process the application or referral, and assign the Lead Source and Lead Source Sub-type. If the application or referral cannot be processed, it is the responsibility of the district or HQ program area to contact the responsible team and explain why the work cannot be completed and return the work if necessary.

Revenue and Payment Report:

- The Revenue and Payment Report was designed to report on a specific Lead Source and Lead Source Sub-type or for an entire Lead Source group. The report is generated from IRIS through the reports sub-menu in the LSR library. It can be requested for a specific TAT (e.g. SR) or a group of TATs (e.g., all Sales and Use Tax TATs). The report may also be sorted by TAT and/or between existing and new accounts.
- The report may be requested for a specific period of time and will automatically generate an accompanying fiscal yearly report, whenever a report is requested. The report is separated into self-assessed and BOE-assessed categories, and will provide tax, interest, penalty, and payments, identified to a Lead Source and Lead Source Sub-type.

Activity Report:

- The Activity Report was designed to provide a history of user activity pertaining to Lead Source and Lead Source Sub-type changes made to an account or FO.
- The report is generated through the *Lead Source Activity Report* screen (LSR RA). The report can be requested for a specific user or for a specific office and can be requested for a specific TAT or TAT group.
- The report will display the before and after description codes, user executing the change or deletion, date, and reason the Lead Source or Lead Source Sub-type was changed or deleted.

Periodic Delinquencies

Failure to file a tax return, even a tax return representing a partial period, constitutes a “periodic” delinquency. In sales and use tax programs, the failure to file a prepayment form appears in the delinquency subsystem in IRIS ~~but does not generate a Notice of Delinquency~~ and automatically generates notices for delinquent sales and use tax prepayments. (Exceptions to this are found in some special taxes programs). A delinquent prepayment does not result in a citation or revocation notice being generated. However, a delinquency assignment for staff to work is created in the Automated Compliance Management System (ACMS).

Through the use of an automated process called the “delinquency control cycle”; (see CPPM 550.020), IRIS identifies taxpayers who have not filed tax or fee returns and controls the preparation of delinquency notices and various reports pertaining to these accounts. The table below provides a summary of the new delinquency and revocation process. ~~The sales tax delinquency control cycle consists of:~~

- ~~1. Establishing a delinquency record approximately four weeks after the due date of the tax return.~~
- ~~2. Issuing a delinquency notice approximately six weeks from the due date of the tax return.~~
- ~~3. Mailing the taxpayer a Notice to Appear—Revocation Proceeding approximately 60 days after issuing the delinquency notice.~~
- ~~4. Mailing the taxpayer a Notice of Revocation approximately 90 days after issuing the Notice to Appear—Revocation Proceeding, and, if the account is revoked.~~
- ~~5. Retaining the record until the delinquency is cleared and the permit or license is reinstated or closed out.~~

Action	Approximate Days
<u>First late notice</u>	<u>Day 14 (via email or mail) after return due date</u>
<u>Second late notice</u>	<u>Day 40 after return due date</u>
<u>Enters collector’s ACMS work list</u>	<u>Day 50 after return due date</u>
<u>Revocation notice</u>	<u>Day 100 after first late notice</u>
<u>Referral to Investigations Division</u>	<u>Day 220 after first late notice</u>

Generally accounts should remain in revoked status for at least 120 days before being referred to the Investigations Division. Accounts may be referred earlier depending on the account’s compliance history, size of liability, or concern for the safety of district staff. The 120 days waiting period will remain in effect to provide the taxpayer an opportunity to clear the account before proceeding toward criminal prosecution.

PARTNERS IN BANKRUPTCY

740.210

When two or more persons are jointly responsible for payment of a BOE tax liability (partnership accounts, husband and wife co-ownership accounts, etc.), ~~SPS-Special Operations Branch (SOB)~~ will be responsible for determining which liabilities, if any, have been discharged by a joint debtor's bankruptcy discharge. If all joint debtors have discharged liabilities, the liabilities may be legally adjusted. If not, the tax liability should not be adjusted, nor should the Discharge From Bankruptcy (DFB) status code be set. If a lien release is appropriate for a discharged joint debtor, but not for all joint debtors, a partial release as to the affected person should be issued.

A partner that is not in bankruptcy is not protected by the automatic stay of a partner in bankruptcy. Collection can continue on the partner not protected by the automatic stay. When a partnership consists of a married couple, marital community property and funds will be protected from collection by the automatic stay of 11 U.S.C. Section 362(a). It does not matter whether one or both of the spouses file for bankruptcy. Most or all of the marital community's property and funds will belong to the bankruptcy estate pursuant to 11 U.S.C. Section 541(a)(2)(A). Case specific questions about community property should be directed to SOB.

Demand Notices for Non-Bankrupt Partners

SOB staff can create and issue a demand notice in IRIS to an individual non-bankrupt partner whose partnership account has a legal designation. The demand copy that is addressed to the partnership, as well as the copy belonging to the partner(s) who filed bankruptcy, will not be produced if a legal designation on the partnership account exists. If a demand notice is created and one or more partners are ineligible to receive the demand due to the legal designation on the partnership account, the demand for the ineligible partners will reject and an assignment (BNK) will be created in assignment control for follow-up by SOB supervision. If a demand notice is created and one or more partners are ineligible to receive the demand due to discharged liabilities, the demand for the ineligible partners would reject and an assignment (DFB) will be created in assignment control for follow-up by SOB supervision. If a notice is suppressed for either reason, the appropriate rejection code will be displayed on the DIF BN screen.

Browse Client/Difference Relationship Screen (DIF XB):

The DIF XB screen displays Difference Client Relationships for a selected Client ID. All account and difference information belonging to the identified client will be displayed. Query fields allow the list to be positioned at a selected relationship type or account number. If a relationship type code is entered in the "Rel" seek field, the list is displayed starting from the relationship type code. If an account number is also entered in the account seek field, the list is displayed starting from the account number. A user can then select a record that will navigate him or her to the Maintain/Inquire Difference Client Relationship screen. The DIF XB screen is available to all BOE staff.

The Browse Client/Difference Relationship screen has a second panel. The second panel provides additional information (e.g., legal case ID, case name) that will help you find the desired record. Press function key F20 in order to access the second panel. The additional information will only appear if the user has entered the legal case ID and case name for the relationship.

Maintain/Inquire Difference Client Relationship (DIF XM):

The DIF XM screen allows a Client Difference Relationship to be entered or viewed. A Client Difference Relationship specifies the type of relationship between the two entities and the date range the relationship was effective. The system will check for a relationship between client and difference and process according to the relationship's existence at the time. For example, if a partner's liability is discharged in bankruptcy, then a demand would not be sent to the partner.

If the Client Difference Relationship is ended, the relationship is no longer in effect for any process that runs after that update. To reestablish the relationship, a new relationship must be created. This new relationship may have the same effective date as the previous record's end date. It may also have the same effective date as the previous record, if the previous record ended the same day. The DIF XM screen may only be accessed and modified by SOB staff.

District Offices and Special Taxes and Fees:

District office and Special Taxes and Fees staff will often enter an account into the legal subsystem when a legal action is pending (Bankruptcy, Probates, Assignments, etc.). The responsibilities and procedures of data entry will remain the same with one exception. Since partners are tracked on an individual basis, the bankrupt partner's Taxpayer Identification Number (TIN) must be entered. The partnership's TIN should no longer be linked to the legal action unless the entire partnership has filed bankruptcy. It is imperative that the bankrupt partner's TIN be entered so the notice process will be effective and accurate.

This functionality will allow the tracking of an individual partner's personal liabilities by providing a comprehensive listing of accounts, differences, and effective dates at the client level. In addition, the system will automatically and accurately determine who is eligible to receive a demand based on the pending legal actions of partnership accounts. This will allow BOE to pursue these types of partnership liabilities without violating the automatic stay and will uphold the goals and objectives of RUPA and BOE.

FARM EQUIPMENT AND MACHINERY

820.091

Under Regulation 1533.1, *Farm Equipment and Machinery*, purchases of vehicles designated as an implement of husbandry in Chapter 1, Division 16 of the Vehicle Code may qualify for a partial exemption from the sales and use tax. To qualify for the partial exemption, a qualified person must use the qualifying vehicle exclusively in agricultural operations.

When a qualified person purchases a new or used qualifying vehicle from a person licensed or certificated pursuant to the Vehicle Code as a manufacturer, remanufacturer, dealer or dismantler (dealer), the qualified person should give a partial exemption certificate to the dealer. However, when a qualifying vehicle is purchased from a seller other than a dealer, for example, an out-of-state vehicle dealer or an in-state non-dealer, and the purchaser does not have a seller's permit, the purchaser must pay the use tax when they register the qualifying vehicle with the DMV or self-report the use tax to the Consumer Use Tax Section (CUTS) or local district office. If the qualified purchaser has a seller's permit they can report and pay the use tax on their sales and use tax return when the property is not subject to registration with DMV.

QUALIFYING PERSONS

Persons who qualify for the partial exemption provided by Regulation 1533.1 must be engaged in an agricultural operation described in Standard Industry Classification (SIC) Codes 0111 to 0291 or perform activities described in SIC Codes 0711 to 0783 in addition to being engaged in a line of business described in SIC Codes 0111 to 0291. A qualified person also includes someone that assists qualified persons by performing an agricultural service, as described in Major Group 7 of the SIC Codes, as an employee or on a contract or fee basis. SIC Codes 0111 to 0291 describe businesses that are engaged in farming and ranching. SIC Codes 0711 to 0783 describe businesses that are engaged in agricultural services to be limited to soil preparation, crop services, veterinary services, animal services, farm labor and management services, and landscape and horticultural services.

A qualified person does not include a person operating a garden plot, orchard, or farm for their own use. Any vehicles or equipment purchased for these applications are not considered purchased for a qualifying use and should not receive the partial exemption from tax.

Please Note: The enacting statute for the partial exemption on sales of farm equipment and machinery, Revenue and Taxation Code section 6356.5, requires the SIC Codes be used to define a qualified person. To ensure consistency with the statutory requirement, Regulation 1533.1 also uses SIC Codes to define a person that assists a qualified person. However, SIC Codes are no longer used on federal income or state franchise tax returns to code a business activity. The standard is now the North American Industry Classification System (NAICS). Any current state franchise or federal income tax return provided by a person as documentation of being engaged in a farming activity will use the NAICS code to describe the person's business activities. (See the Proof of Exemption section.) If staff has questions concerning the eligibility of a NAICS code, a cross-reference between the SIC and NAICS codes can be found at www.census.gov/eos/www/naics/concordances/concordances.html.

The following examples illustrate the concept of “qualified persons.”

Example 1: Farmer Bob grows tomatoes on his 2,000-acre farm and is a qualified person for purposes of Regulation 1533.1. Farmhand Jake is Farmer Bob’s employee and assists Farmer Bob in planting and harvesting tomatoes. Farmer Bob is very busy so he sends Farmhand Jake, on his behalf, to buy a used qualifying vehicle from Farmer Steve. Farmhand Jake is a person that qualifies for the partial exemption because he is a person that assists a qualified person as he performs agricultural services as described in SIC Codes 0711 to 0783, as an employee of Farmer Bob.

Example 2: Farmer Bob decides he is not going to do his own fertilizing this year. Farmer Bob contacts The Giant T’Mater Fertilizing Company and contracts with them to fertilize his tomatoes this year. This is a big contract for The Giant T’Mater Fertilizing Company, so they decide to buy a new qualifying fertilizer applicator rig from an out-of-state retailer for use exclusively in agricultural operations. The Giant T’Mater Fertilizing Company performs agricultural services described in SIC code 0711, soil preparation services, and therefore qualifies as a person that assists a qualified person.

Example 3: Farmer Bob’s mom is ill, so next year he will contract out the management of the tomato fields, including cultivating and harvesting, with Bestfriend Farm Management Co. Bestfriend Farm Management Co. buys a used qualifying vehicle for use exclusively in getting around on the farm property and to check irrigation machines. Bestfriend Farm Management Co. is a person that assists a qualified person (SIC 0762) and therefore qualifies for the partial exemption.

Example 4: Citizen Jeff works a vegetable patch in his extra-large backyard. He consumes most of the vegetables but occasionally sells produce at a roadside stand. He does not report such sales and expenses on his federal income tax return. Citizen Jeff’s purchases do not qualify for the partial exemption because he is not a qualified person. He is growing produce for his own use and is not engaged in a business for purposes of Regulation 1533.1.

QUALIFYING VEHICLES

Regulation 1533.1 states that an “implement of husbandry” is a vehicle used exclusively in the conduct of agricultural operations. It also states that an “implement of husbandry” does not include vehicles designed primarily for transportation of persons or property on the highway, unless specifically designated as such by provisions of the Vehicle Code.

Vehicle Code section 36005 provides a list of vehicles that qualify as “implements of husbandry.” This list is attached to Regulation 1533.1 as Appendix A. Assuming the person claiming the partial exemption can document they are a qualified person, staff should allow the partial exemption for the types of vehicles listed when used exclusively in the conduct of agricultural operations or as otherwise indicated.

There are occasions when vehicles not specifically identified in Appendix A may qualify as farm equipment and machinery for the purposes of the partial exemption. For example, while the Vehicle Code states that, in general, vehicles designed to transport persons or property on a highway are not qualifying vehicles, such vehicles are included in Vehicle Code section 36005 as implements of husbandry. It should be

noted that this section limits their on-highway use to short distances that are incidental to farming, not for compensation, and no more than two (2) miles. Additionally, the DMV will occasionally qualify vehicles not listed in Vehicle Code section 36005 as implements of husbandry. This determination is made by the DMV's Special Processing Unit and is based on a review of the vehicle's use and equipment requirements.

Depending on their use, unlisted vehicles such as All Terrain Vehicles (ATV) and agricultural aircraft (crop dusters) may be considered qualified vehicles if used exclusively in an agricultural operation to traverse an agricultural property to check fencing, round up livestock, check cattle and crops, examine watering and irrigation systems, or similar activities required in an agricultural operation. When used exclusively for these purposes, the purchase of the ATV qualifies for the partial exemption provided all other requirements of Regulation 1533.1 are met. Similarly, crop dusters used exclusively for seeding, fertilizing, and crop protection will qualify for the partial exemption.

PROOF OF EXEMPTION

When a qualifying vehicle is purchased from a person registered with the BOE to collect tax, the purchaser must complete a partial exemption certificate in support of a claimed partial exemption. A sample of the recommended partial exemption certificate can be found in Appendix B of Regulation 1533.1. The purchaser is not required to use the recommended partial exemption certificate as long as the certificate provided by the purchaser has all of the elements for the partial exemption certificate outlined in Regulation 1533.1.

Purchasers that report use tax to, or claim a refund from, the BOE must also provide evidence of being engaged in one of the required SIC codes. Acceptable documentation includes current federal income or state franchise tax returns which include Schedule F. If the purchaser did not file a Schedule F, staff should check the NAICS code on the return to ensure it matches one of the activities qualifying for the partial exemption. (Refer to Regulation 1533.1.)

It is possible that a person who assists a qualified person will not have a NAICS code that matches one of the activities qualifying for the partial exemption. If the purchaser cannot provide a Schedule F or appropriate NAICS code, other documentation, such as employment or service contracts, may be accepted.

DEPARTMENT OF MOTOR VEHICLE (DMV) CUSTOMERS

DMV cannot process partial payments of the use tax on behalf of the BOE. Therefore, purchasers have two options for reporting and paying use tax:

OPTION 1: Pay the non-exempt portion of the tax to the BOE (CUTS/district office) and obtain a BOE-111, Certificate of Tax Clearance, to present to DMV to allow registration.

OPTION 2: Pay the full amount of use tax to the DMV and apply for a refund of the state exempt portion directly from the BOE.

PROCEDURES

District Offices

If a taxpayer is claiming the partial tax exemption, direct them to register electronically using the kiosk. When the taxpayer electronically registers, a source information file (SIF) number is generated, which will be used by CUTS to create an account.

After the taxpayer electronically registers, they will still need to submit their claim by completing the BOE-106 as normal. Staff should ensure the BOE-106, Vehicle/Vessel Use Tax Clearance Request, is completed with all pertinent information as outlined in CPPM section 840.005, Voluntary Payments. The clearance (BOE-111) should be issued only if the purchaser provides supporting documentation that the purchaser is engaged in agricultural operations. District office staff should forward the documents to CUTS and reference the SIF number created during the online registration process.

The partial exemption should generally not be allowed for a vehicle designed to haul persons or property on a highway, but not specifically listed in Vehicle Code section 36005. A vehicle whose existing design is primarily for the transportation of persons or property on a highway, such as a pickup truck, trailer, truck tractor or truck tractor and semi trailer combination, does not qualify for the partial exemption, unless such a vehicle is otherwise specified as an implement of husbandry in the Vehicle Code Section 36005. To qualify for the partial exemption, the purchaser must obtain a determination from the DMV that the vehicle qualifies as an implement of husbandry. A registration slip showing this determination must be presented to the BOE when the tax is paid or the refund is claimed.

District staff must also check IRIS to see if there is an existing CUTS SIF or account number (SA/SB UT XX-XXXXXX). To search for an existing CUTS account, go to the CUT SS screen in IRIS. Enter either the *Vehicle Identification Number (VIN)* or *vehicle license plate number* in the appropriate field and press enter. To search for an undocumented vessel, use the *hull ID number or vessel license number*.

Requests involving aircraft and documented vessels (vessels registered with the USCG) should be referred to CUTS for review. BOE-111's are not issued on transactions involving aircraft or documented vessels.

Consumer Use Tax Section (CUTS)

If the taxpayer is claiming the partial tax exemption, accept the payment of tax less the amount of the partial exemption, then process the BOE-111, Certificate of Tax Clearance, request as normal. Staff should ensure the BOE-106, Vehicle/Vessel Use Tax Clearance Request, is completed with all pertinent information as outlined in CPPM section 840.005, Voluntary Payments. The clearance should be issued only if the purchaser provides documentation that the purchaser is engaged in agricultural operations.

CUTS staff must also verify whether there is an existing SIF or account number as instructed above.