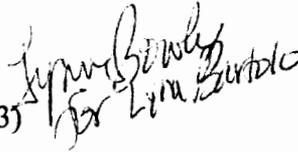


# Memorandum

**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 Audit Manual (AM) Chapter 1, General Information**  
**AM Chapter 4, General Audit Procedures; and AM Chapter 6,**  
**Vehicle, Vessel and Aircraft Dealers**

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 proposed revisions incorporate current policies and procedures into the following chapters:

- AM Chapter 1, *General Information*
- AM Chapter 4, *General Audit Procedures*
- AM Chapter 6, *Vehicle, Vessel and Aircraft Dealers*

The 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:ljm

Attachment

Approved:

**STATE BOARD OF EQUALIZATION**

BOARD APPROVED



At the March 30, 2016 Board Meeting



Joann Richmond, Chief  
Board Proceedings Division

  
Mr. David Gau  
Chief Deputy Director

cc: (all with attachment)  
Mr. Wayne Mashihara (MIC 47)  
Ms. Susanne Buehler (MIC 92)  
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)

## EDUCATIONAL CONSULTATIONS

0110.00

### BACKGROUND

0110.02

The Educational Consultation Program (Program) ~~was~~ is designed to provide sales and use tax information to new taxpayers during the taxpayers' first year of business to help taxpayers meet the sales and use tax reporting requirements.

~~Under the Program~~ The consultation should be performed by ~~, the district field offices designate one~~ an experienced ~~tax auditor consultant (consultant)~~ who reviews the taxpayer's<sup>2</sup> business operations, record-keeping and tax preparation system. This personal assistance is an educational opportunity for taxpayers to obtain answers to sales and use tax questions, as well as any general questions regarding the Board of Equalization (BOE) Board. The Program is provided at no charge and is available upon taxpayer request. ~~The consultations are provided at no charge to the taxpayer and~~ Consultation appointments ~~normally~~ typically last no more than one day.

4

### PRE-CONSULTATION ACTIVITIES

0110.04

#### **Headquarters' Responsibilities**

~~Consultation Selection~~ Once a taxpayer contacts a district office requesting a consultation, the district should ~~The Tax Policy Division, Field Support and Evaluation unit (FSE), will select accounts eligible for consultations using the following criteria:~~ verify that the requesting taxpayer is eligible for the Program. To be eligible, the taxpayer must have:

1. Started a new business within the last twelve (12) months.

~~1.~~ 2. Filed at least two sales and use tax returns, ~~and~~

~~e. Have a business or North American Industry Classification System (NAICS) code that has historically had reporting problems or is in an industry with recent law or regulatory changes.~~

~~FSE staff in Headquarters will create for each of the participating districts a list of the selected accounts twice per year. Taxpayers who meet the first two criteria above, but who do not meet criteria (c), may voluntarily request a consultation. Although outside the guidelines as set forth in criteria (1.), district offices have the discretion to perform consultations for taxpayers who have been in business for more than 12 up to 18 months. Taxpayers who do not meet the consultation criteria, who have been in business for more than 18 months, or who are not registered with the Board do not qualify for an educational consultation. However,~~ sSuch taxpayers may request a consultation and amend returns (CPPM section 505.120) within the appropriate statute of limitations. ~~However,~~ Tthe taxpayer must be advised that since the taxpayer does not meet the criteria for an educational consultation, the consultation ~~that~~ the taxpayer will ~~receives~~ may result in the ~~Board~~ BOE conducting a full audit based upon its findings.

<sup>2</sup>As of December 2006, Equalization Districts One, Two and Four have fully implemented the Program, while the Third Equalization District provides the service upon request only.

## CONSULTATION ACTIVITIES

0110.06

### ~~District Responsibilities~~

#### Consultation Appointments and Taxpayer Contact

The ~~auditor~~consultant ~~will~~ contacts the taxpayer and schedules an appointment to conduct the consultation at the place of business of either the taxpayer or the taxpayer's representative, or the ~~consultant~~auditor ~~will~~ makes arrangements to have the taxpayer furnish enough records and tax returns so ~~that~~ an in-office consultation can be performed. The ~~auditor~~consultant ~~will~~ then mails Form BOE-1297, *Taxpayer Education Consultation Program Appointment Confirmation Letter*, to the taxpayer confirming the appointment. The letter ~~should~~ includes the appointment date and time, and it ~~should~~ describes the extent of the ~~consultant~~auditor's anticipated brief examination of the taxpayer's records.

Contact information throughout the consultation process may be documented on Form BOE-414-Z, *Assignment ~~Contact~~ Activity History*, using the BOE-414-Z program.

#### Examination of Records

At the taxpayer's place of business, the ~~consultant~~auditor will perform the following:

1. Discuss the taxpayer's business and type of operation
2. Examine the business and its facilities
3. Examine the taxpayer's books and records
4. Examine the taxpayer's sales and use tax returns and review with the taxpayer how the returns are prepared
5. Provide the taxpayer with applicable publications and/or regulations
6. Answer any questions the taxpayer may have with regards to the taxpayer's sales and use tax account or any other ~~Board~~BOE services.

If an examination of the taxpayer's place of business was not performed (e.g., consultation was conducted at the taxpayer's representative's place of business), a note to that effect will be disclosed in the "Other Comments" section of Form BOE-1300, *Taxpayer Educational Consultation Report*.

## POST-CONSULTATION ACTIVITIES

0110.10

### ~~District Responsibilities~~

When the consultation is complete, the ~~consultant~~auditor will discuss findings or concerns (if any) with the taxpayer and give recommendations to remedy or correct the identified issues. The taxpayer will also be advised about the areas that are being handled correctly to reinforce those areas.

1. Material Debit Amount Discovered

If the ~~consultant~~auditor finds a material debit discrepancy, the ~~consultant~~auditor will ~~advise~~instruct the taxpayer to amend its return(s) and pay the appropriate tax and interest.

## POST-CONSULTATION ACTIVITIES

(Cont.) 0110.10

### 2. Material Credit Amount Discovered

If the ~~consultant~~auditor finds a material credit discrepancy, the ~~consultant~~auditor will furnish the taxpayer with Form BOE-101, *Claim for Refund or Credit*, and instruct the taxpayer how to properly file the claim.

### 3. Educational Consultation Report ~~and Consultation Survey~~

After completion of the consultation, the ~~consultant~~auditor will complete Form BOE-1300, *Taxpayer Educational Consultation Report* (Report), and either Form BOE-1298, *Taxpayer Educational Consultation Program Letter (Findings)*, or Form BOE-1299, *Taxpayer Educational Consultation Program Letter (No Findings)* cover letter, depending on the outcome of the consultation. The Report form requires the following information:

- Taxpayer's name
- Account number
- Contact person
- Date of consultation
- Accountant (if applicable)
- Periods of returns previously filed
- ~~Consultant~~Auditor's name
- Supervisor's name
- Reviewer's name
- Date of review
- Type of business
- Hours spent
- Type of cover letter sent
- Books and records information
- Types of sales
- Deductions and purchases.

While ~~each~~every consultation varies from taxpayer to taxpayer, district staff shall make ~~and~~ efficient use of ~~their~~ time spent on consultations (e.g., 8 hours per consultation recommended). The ~~consultant~~auditor ~~will submit~~furnish the Report ~~to the district reviewer for review~~to their supervisor in the same manner as other audit cases. The ~~district reviewer will review~~s the Report for accuracy and related comments, and ~~then enters~~ the date in the section "Date of Review" and signs in the section "Reviewed By" on the Report. Both the Report and the cover letter must be mailed to the taxpayer. ~~along with Form BOE-1301, State Board of Equalization Educational Consultation Survey (Survey). The account name and number should be listed on the Survey and a self-addressed postage paid envelope should be included in the mailing. Taxpayers are asked to complete the Survey and mail it back via the self-addressed postage paid envelope directly to the Audit Support Unit (MIC 44) in Headquarters.~~ Field staff should archive this report in the digital audit archive. In addition, staff should forward a copy of the Report ~~make two copies of the Report form retaining one copy in the district office file and forwarding the other copy~~ to the Taxpayer Records Unit (MIC 36).

## POST-CONSULTATION ACTIVITIES

(Cont.) 0110.10

In the “Other Comments” section of the Report, the ~~consultant~~auditor should record any publications or regulations provided to the taxpayer, along with any errors discovered and the appropriate action taken or discussed to correct them (e.g., amended returns). The cover letter to the taxpayer should explain the purpose of the consultation and that it was not an audit of the books and records. The letter should also instruct the taxpayer to amend its returns, if applicable.

Presentation of a taxpayer’s books and records to a tax auditor for examination is considered a written request for ~~an~~the audit report. If a prior audit report of ~~the~~a person requesting [RTC section 6596](#) relief contains written evidence that demonstrates the issue in question was examined, such evidence will be considered “written advice from the BOE” and qualify for relief under RTC section 6596. (AM section 0105.04.) The same holds true for a consultation wherein the ~~consultant~~auditor examines the taxpayer’s books and records and completes the Report form. ~~Consultant~~Auditor staff should be careful to accurately describe the types of transactions and records examined because only those types of transactions and/or records will qualify as written advice from the ~~BOE~~Board under RTC section 6596. ~~A taxpayer cannot file a valid RTC section 6596 claim for relief regarding T~~transactions and records not examined by the ~~consultant~~auditor ~~will not qualify as written advice from the Board under RTC section 6596~~—should the taxpayer dispute ~~an audit finding a transaction~~—at a later date. Therefore, ~~consultant~~auditors should describe in the Report transactions the taxpayer engages in, but were not examined during the consultation. For example, “Claimed exempt shipping charges were not verified against actual shipping documents.”

~~Consultant~~Auditors should also be aware of transactions the taxpayer may be entering into in the future. Any discussions about future types of transactions should also be described in the “Other Comments” section of the Report form. For example, if the taxpayer does not have sales for resale, the ~~consultant~~auditor will describe and note that he/she explained to the taxpayer the proper elements of a resale certificate and any other types of records used to support claimed nontaxable or exempt sales, etc. ~~The application of tax and correct record-keeping explained to the taxpayer for A~~any (future) transactions ~~explained to the taxpayer~~—should be documented in IRIS.

In the discussion, ~~consultant~~auditors should explain that advice regarding future transactions constitutes oral advice and does not serve as ~~a~~ basis for RTC section 6596 relief. The ~~consultant~~auditor should also explain the application of RTC section 6596 and Regulation 1705 and stress the importance of obtaining written advice. See AM section 0105.00 for RTC section 6596 relief guidelines.

### ~~Statistics~~ Follow-up Actions

~~On a monthly basis, the district consultant will report his or her educational consultation activity utilizing the District Reports Database (DRD). The District LAN Coordinator, at the direction of the District Principal Auditor (DPA), must grant the consultant or other designated Board staff access to the DRD in their respective district office. The “Education Consultations” button in the DRD will bring the viewer to the first screen prompting him or~~

~~her to enter the total hours<sup>2</sup> (Time Code 3208) for the Program for the month. If there are no completed consultations to enter, the user will press the “Done” button.~~

~~If there are completed consultations to enter, the user will press the button at the bottom of the form, which will take the user to the “Completed Consultations” screen. The “Completed Consultations” screen will require the following data be entered:~~

~~Taxpayer account number (numerical portion only). For example: 100-999999~~

~~Taxpayer name~~

~~Taxpayer’s phone number~~

~~Consultant name~~

~~Date of consultation~~

~~Type of Consultation Letter (i.e., N=No Change; C=Change; R=Refund)~~

~~Hours spent.<sup>3</sup>~~

~~Once the user has entered the required data for a consultation, he or she will press the “Add Record” button, which will allow for other completed consultations to be entered into the DRD. If no other consultations were completed, the user will press the “Done” button. Should staff experience any problems with the DRD, they should contact the FSE unit directly.~~

~~The [consultant/auditor](#) should enter ~~the~~ appropriate comments in IRIS (TAR AI Comments screen) to document that a consultation was [requested](#)~~offered~~ and completed, rejected, refund recommended, etc. ~~If a consultant elects to send a bulk quantity of letters soliciting consultation appointments and receives no response, each letter to each taxpayer will constitute a contact and “no response” should be noted in IRIS. If the consultant elects to contact the taxpayer via telephone and receives no response, such telephone efforts towards the one taxpayer will also constitute a single contact.~~~~

Either the [consultant/auditor](#) or the [consultant/auditor](#)’s supervisor should track accounts for which the taxpayer was instructed to amend his or her returns. If the taxpayer has not submitted amended returns after six (6) months from the notification date [or earlier if the statute of limitation is approaching](#), the [consultant/auditor](#) should inform his or her supervisor, who will then flag the account for [follow up/audit](#).

#### ~~Consultation Surveys~~

- ~~• Any Survey forms received in the district office should be forwarded to the Audit Support Unit (MIC 44) for recording.~~

#### **Headquarters’ Responsibilities**

##### ~~Consultation Surveys and Statistics~~

~~Audit Support Unit (MIC 44) staff will accumulate the completed Surveys and statistics from the field staff. A report to management will be prepared semiannually summarizing these statistics and any comments provided by the taxpayer.~~

<sup>2</sup>-Total hours for the Program will include all time spent by the consultant to make phone calls, hold consultations, and other administrative duties related to the Program in the respective month.

<sup>3</sup>-Hours entered here will pertain only to the consultant’s hours spent on this account’s specific educational consultation.

## AUDIT OF RETURNED MERCHANDISE

0413.00

### GENERAL

0413.05

A deduction for returned merchandise must meet the requirements of Regulation 1655, [Returns, Defects and Replacements](#). Actual returns of taxable sales are deductible if the following conditions are met:

- The original sale is included in reported taxable sales.
- The full sales price, including sales tax, is refunded either in cash or credit. For purposes of the returned merchandise deduction, “full sales price” is construed to include only amounts required to be included in the measure of tax under [RTC sections 6011 and 6012](#), plus any sales tax added. [Charges not required to be included in the measure of tax, such as nontaxable shipping charges, need not be refunded in order to claim the returned merchandise deduction \(even if sales tax was erroneously collected on such charges\).](#)
- ~~For example, transportation charges not subject to sales tax need not be refunded in order to claim the returned merchandise deduction (section 0413.25).~~
- The customer ~~in order to obtain the refund or credit~~ is not required to purchase other property at a price greater than the amount charged for the property returned [in order to obtain the refund or credit](#).

Refund or credit of the entire amount is deemed to be given when the purchase price and sales tax, less rehandling and restocking costs, if any, are refunded or credited to the customer. The refund or credit should be computed in the following manner:

#### Example 1

<u>Price of merchandise returned</u>	<u>\$100.00</u>
<u>Sales tax @ 7.5%</u>	<u>\$7.50</u>
<u>Total</u>	<u>\$107.50</u>
<u>Restocking and rehandling charge</u>	<u>\$10.00</u>
<u>Amount refunded or credited</u>	<u>\$97.50</u>

If the retailer sets up a credit in its books rather than refunding cash, the retailer must provide proof that the customer was notified of the available credit. Generally, a deduction for returned merchandise should not be allowed if the retailer did not give written notice to the customer that the credit is available.

~~Credit for returned merchandise cannot be allowed if the retailer sets up a credit in the books but fails to give written notification to the customer that the credit is available.~~

### METHODS OF CLAIMING THE DEDUCTION

0413.10

Merchandise returns are generally entered in the taxpayer's books in one of the following ways:

- As debits to an account in the general ledger, and claimed as a deduction on the sales tax return. The deduction, when handled in this manner, should be audited in the same way as any other deduction.
- As debit entries in the sales journal (therefore, a reduction in sales) with no deduction being shown on the sales tax returns. When this procedure is followed the verification of the deduction should be made in conjunction with the audit of total sales ([AM section 0413.20](#)).

## AUDITING PROCEDURE — DEDUCTION CLAIMED

0413.15

The original documents covering returned merchandise usually consist of credit memoranda which, together with the original sales invoices, are the basis of the credit. Occasionally, an auditor will encounter a situation where no credit memoranda are issued, the taxpayer merely marking on the original invoices or in the sales journal the words “canceled” or “returned.” Such returns or cancellations should not be allowed unless the taxpayer can furnish documentary evidence of returns actually made and meeting the conditions listed in [AM section 0413.05](#). ~~All nontaxable elements of the sale must be eliminated.~~ The claimed deduction can be audited on a complete basis or a test basis, depending on the frequency of returns and the amounts involved.

## AUDITING PROCEDURE — DEDUCTION NETTED FROM SALES

0413.20

When returned merchandise is “netted” from total sales ([AM section 0413.10](#)), a separate verification of the returns cannot be made as there is no control of the recorded or netted amounts. The verification must therefore be combined with the examination of total sales, all credit memoranda being examined at the time the sales tickets are examined. All netted items not meeting the requirements listed in [AM section 0413.05](#) are to be treated as additional taxable sales not reported and may be combined with unreported or unrecorded sales as a basis for computing an understatement of taxable sales.

## SHIPPING AND HANDLING CHARGES

0413.23

Under RTC sections 6011 and 6012, as explained in Regulation 1628, *Transportation Charges*, separately stated charges for transportation from the retailer’s place of business or other point from which shipment is made directly to the purchaser are not subject to tax. The amount of transportation charges excluded from the measure of tax shall not exceed the actual cost of the transportation. If a separately stated charge is made designating “postage and handling” or “shipping and handling,” only that portion of the charge which represents actual postage or actual shipping may be excluded from the measure of tax. The amount excluded from the measure of tax need not be refunded in order for a retailer to claim a returned merchandise deduction. If tax is erroneously collected on nontaxable shipping charges, this amount also does not need to be refunded because it constitutes excess tax reimbursement which has already been properly remitted to the State (AM section 0417.00).

Handling charges are included in the definitions of “sales price” and “gross receipts” and are included in the measure of tax. Therefore, handling charges, including the portion of the sales tax related to the handling charges, must be refunded to the customer in order to claim the returned merchandise deduction.

In cases where a deduction is claimed for the returned merchandise but the taxpayer does not refund the amount attributed to handling, this will be deemed to be a restocking charge. The retailer will be permitted a returned merchandise deduction as long as the handling amount does not exceed the actual cost of restocking. The auditor should accept the deduction without further examination in cases where the handling charge is less than 10 percent of the sales price attributed to the actual merchandise in the original transaction.

If the handling charge is in excess of 10 percent of the sales price of the merchandise, the auditor should examine a sample of transactions to ensure the handling charge does not exceed the actual cost of restocking the merchandise. When “postage and handling” or “shipping and handling” charges are billed as lump sum, the handling charge would be considered the lump sum charge minus the actual cost of postage or shipping.

**SHIPPING AND HANDLING CHARGES****(CONT.) 0413.23****Example 2**

A retailer makes a sale and charges the customer:

<u>Sale</u>	<u>\$100.00</u>
<u>Shipping and Handling</u>	<u>\$15.00</u>
<u>Subtotal</u>	<u>\$115.00</u>
<u>Sales Tax (7.5% X \$115)</u>	<u>\$8.63</u>
<u>Total</u>	<u>\$123.63</u>

The retailer remits the full amount of the tax to the State. When the merchandise is returned, the retailer refunds:

<u>Returned Merchandise</u>	<u>\$100.00</u>
<u>Sales Tax (7.5% X \$100)</u>	<u>\$7.50</u>
<u>Total</u>	<u>\$107.50</u>

The actual cost of shipping is \$8 and the handling charge is therefore \$7 (\$15 - \$8 = \$7). The auditor should accept the returned merchandise deduction because the \$7 handling charge is less than 10 percent of the selling price of the merchandise (\$7/\$100); therefore, the retailer is allowed to retain that amount as a restocking fee.

When determining whether the returned merchandise deduction should be examined further, staff must first rely upon the use of aggregate data as illustrated in Example 3 as the intent of the 10 percent threshold is to avoid detailed testing. This is especially true when it is highly improbable that the original handling charge is in excess of the actual cost of restocking merchandise.

**Example 3**

Assume the same facts and circumstances noted in Example 2 above. Additionally, the taxpayer's records for the prior year state:

<u>Total Sales (net of shipping and handling)</u>	<u>\$15,000,000</u>
<u>Shipping and Handling Revenue</u>	<u>\$1,000,000</u>
<u>Shipping Merchandise Expenses</u>	<u>\$700,000</u>

Under this scenario, staff would consider that \$300,000 in revenue is derived from handling charges (\$1,000,000 - \$700,000). For the specific period in question, the handling charge is 2 percent of total sales (\$300,000/\$15,000,000). Since the handling charge is less than 10 percent of the merchandise sales, the claimed returned merchandise deduction should be accepted without further testing.

In the event that adequate documentation is not available to use aggregate data, staff should perform a cursory review of transactions to determine if the retailer qualifies under the 10 percent threshold explained above.

It is important to note that in cases where the handling portion exceeds 10 percent of the sales price, the returned merchandise deduction is not necessarily disallowed. The deduction must be further analyzed to verify whether the un-refunded handling portion of the original sale exceeds the actual cost of restocking the merchandise. Only in such cases should staff deny the claimed returned merchandise deduction or claim for refund.

## REHANDLING AND RESTOCKING CHARGES

0413.25

There are two methods of compiling the cost of rehandling and restocking returned merchandise. The retailer may use:

- (a) The actual cost of rehandling and restocking the returned merchandise. The cost may include, but is not limited to the retailer's direct costs of the following:
  - Inspection of the merchandise after the request has been made for its return
  - Issuance of authorization for return of the merchandise after the request has been made for its return
  - Freight or delivery charge for shipment of the merchandise from the customer to the retailer
  - Returning the merchandise to stock, and
  - Direct "paper work" involved in the return of merchandise such as preparation of credit memos, accounts receivable corrections, inventory record adjustments, etc., to the extent that it is possible to determine these costs.
- (b) A percentage of the sales price based on the average cost of rehandling and restocking returned merchandise.

The percentage must be based on the average of the actual costs of rehandling and restocking the returned merchandise for the entire previously completed accounting cycle (normally one year). The percentage is computed by dividing the total allowable rehandling and restocking costs incurred in the previous accounting cycle by the total sales price (excluding sales tax) of the merchandise returned during that period. Retailers choosing the percentage of sales method may not:

- Use industry-wide averages
- Use actual cost during any accounting cycle in which an election was made to use the percentage method.

Regardless of which of the two methods is used, only the actual cost or average actual cost of rehandling and restocking returned merchandise is allowable. The taxpayer must maintain adequate records to support how the charge for restocking and rehandling was determined. If the taxpayer incorrectly computes the percentage and ~~and accordingly charges a~~ charges a greater restocking charge, ~~incorrect restocking charge~~ for the entire subsequent year, only those transactions where the actual restocking costs on any specific transaction are equal to or greater than the erroneous percentage claimed may be allowed.

~~Delivery charges and other charges that are subject to tax as a part of the "gross receipts" must be included in the total sales price when computing the applicable percentage for rehandling and restocking. The computed percentage is applied to the total sales price (excluding sales tax) of merchandise subsequently returned to arrive at the allowable rehandling and restocking charges for sales and use tax purposes. The refund or credit should be computed in the following manner:~~

<del>Price of merchandise returned.....</del>	<del>\$100.00</del>
<del>Sales tax @ 7.25%.....</del>	<del>\$7.25</del>
<del>Total.....</del>	<del>\$107.25</del>
<del>Restocking and rehandling charge @ 10% (\$100 x .10).....</del>	<del>\$ 10.00</del>
<del>Amount refunded or credited.....</del>	<del>\$ 97.25</del>

## **RETURN OF TAX REIMBURSEMENT**

**0413.26**

If the retailer separately computes the sales tax refund or credit at an amount less than the sales tax on the original transaction, the difference between the sales tax collected and the sales tax refunded is regarded as excess tax reimbursement and should be handled in accordance with [AM](#) section 0417.00.

## **EXAMINATION OF ACCOUNTS RECEIVABLE**

**0413.30**

The auditor should examine a sufficient number of individual customers' accounts to satisfy themselves that the credit memoranda on file actually represent bona fide credits of the original sales price plus tax. Some retailers issue a credit memo in full but make a service charge or some charge other than a restocking or rehandling charge to the customer. If this condition is discovered, the auditor should disallow the deduction.

It will be noted that Regulation 1655 states in part, "...the full sales price,...is refunded in cash or credit..."

Where the retailer has issued a credit memo and notified the customer in writing at the last known address that a bona fide credit for the full sales price including sales tax is available and the customer's account is so credited, the deduction is allowable. This will be true even though the customer does not utilize the credit and after a reasonable period of time the retailer transfers the unused credit to miscellaneous income or some other income account.

## **DEFECTIVE MERCHANDISE**

**0413.35**

When defective merchandise is returned to the seller, under conditions not meeting the requirements of Regulation 1655 ([AM section](#) 0413.05), a deduction may be taken only for the amount credited or refunded because of the defective condition of the merchandise. No deduction can be allowed for the amount refunded or credited because of the return of the merchandise. Accordingly, where the returned defective merchandise has some value, the amount refunded or credited to the customer must be reduced by the value of the merchandise in its defective condition.

## **PRICE ADJUSTMENTS**

**0413.40**

Occasionally, the auditor will encounter situations where amounts claimed as returned merchandise represent price adjustments on merchandise actually retained by the customer. For example, a customer is not entirely satisfied with the merchandise and wishes to return it. The seller, not wanting to restock the merchandise, will prevail upon the customer to keep the merchandise at a reduced price. The price adjustment is then refunded or credited to the customer. Such price adjustments will be deductible if the customer is actually given a refund in cash or a credit in an amount equal to the agreed upon adjustment, plus sales tax on that amount.

## INTRODUCTION — VEHICLE DEALERS

0601.00

### GENERAL

0601.05

A motor vehicle is generally defined as a device which is self-propelled, such as an automobile or truck, and used on a highway to move persons or property. (For the specific definitions see Revenue and Taxation Code (RTC) sections 6022 and 6272.) The material included in this chapter not only applies to audits and records of motor vehicle dealers, but also applies to audits of the records of any seller whose transactions are similar to those of a motor vehicle dealer. ~~This is particularly~~ such as dealers of house trailers, motorcycles, recreational vehicles, jet skis, snowmobiles and tractors.

Exhibit 10 lists sources of information, which may be helpful for both audit and compliance purposes and which are available to staff via the Internet.

### SALES OF VEHICLES BY NON-DEALER RETAILERS

0601.07

RTC section 6282 provides an exemption for sales tax on the sales of vehicles required to be registered under the Vehicle Code when the retailer is not a licensed manufacturer, remanufacturer, dealer, dismantler, or lessor-retailer. Under such circumstances, RTC section 6292 provides that the purchaser is required to pay the applicable use tax to the Department of Motor Vehicles (DMV) when registering the vehicle. Therefore, the sale of a vehicle by a non-dealer retailer (e.g., an auctioneer who is not a registered dealer) is exempt from sales tax when such vehicle is required to be registered under the Vehicle Code.

The exemption applies regardless of whether the purchaser will ultimately register the vehicle with the California DMV or a similar out-of-state agency. As such, DMV registration documents or similar registration documents from another state are sufficient to establish that the vehicle sold is a vehicle required to be registered under the Vehicle Code or similar out-of-state law codes.

Dealers buy and sell cars at wholesale and retail [at](#) auctions. Wholesale auctions permit only dealers to buy or sell, while retail auctions are open to the general public as well. Each auction is run independently, maintains different records, and has its own procedures. Some standard auction procedures may include:

- Every dealer must register with the auction.
- The dealer will provide the auction with the year, make, VIN, and equipment of each vehicle offered for sale.
- The auction will issue the selling dealer an auction check, and assume the risk of collection on the buyer's check.
- The auction will handle the actual assignment of title to the buyer and collect and report the sales tax.
- ~~Seller~~ [The seller](#) may set a floor or lowest price that the car may be sold for by the auction.
- Each party will receive an invoice that shows the vehicle sold, and the identities of the buyer and seller.

~~Some dealers purchase large amounts of vehicles from auctions, and the auditor should contact these auctions to obtain a print out of vehicles purchased.~~ Some dealers may bring a customer to a wholesale auction, in violation of auction policy, and collect an auction fee for their service. In this case, the auction sells the car to the dealer for resale and the dealer gives the paperwork to the customer with instructions to register the vehicle at DMV. The vehicle is not entered in the car dealer's inventory or sales records. The auditor needs to be alert for these transactions as the buyer may not report the correct amount of tax.

### **REQUESTING AUCTION HOUSE DATA**

Some dealers purchase large amounts of vehicles from auctions. The Data Analysis Section (DAS) maintains an auction house database of wholesale used car sales based on information obtained from the largest known auction houses. The database includes the following information:

- Auctioneer name
- Purchaser's name and address
- Purchase date
- Description of vehicle purchased (VIN, make, model)
- Purchase price

The above information may be of assistance when verifying reported taxable sales, identifying a dealer on non-dealer's purchases, projecting or supporting an estimated tax liability, or ensuring compliance with other registration and reporting requirements.

## AUCTIONS

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Auditors must first request available auction house data from DAS prior to contacting any wholesale auction house. Requests should be sent via email to DataReq@boe.ca.gov with "Auction House Data" in the subject line. DAS will provide the matching auction purchase data with a list of auction houses searched. If DAS does not have the requested data available, the auditor may send a written request for data to the appropriate auction house(s) that were not searched.

All requests for auction house data should include the owner's name, DBA, business address and seller's permit number, at a minimum.

## REQUESTS FOR DMV INFORMATION FROM CONSUMER USE TAX SECTION

0606.15

The Consumer Use Tax Section (CUTS) may be contacted to resolve issues between the audit staff and the taxpayer as to whether the use tax was paid to DMV by a taxpayer on a purchase of a vehicle or undocumented vessel.

CUTS has on-line access to DMV vehicle/undocumented vessel registration and use tax payment information. The basic record is referred to as an R67 inquiry and contains a description of the vehicle/undocumented vessel, registration card and ownership certificate issue dates, and name and address of the registered owner. Several subrecords can be found in this basic record including Sub: B which may indicate whether use tax was paid. The code "1" is used to indicate use tax was paid and "2" to indicate that no use tax was paid. For a complete list of R67 information and status codes see exhibit ~~129~~.

Additional ~~information documents available from DMV include such as~~ Registration Receipt, Certificate of Title (pink slip), Bill of Sale, Statement of Fact, Power of Attorney, and other documents provided to DMV upon registration, ~~may be available upon review of the microfilm.~~

Auditors ~~requesting needing~~ DMV registration or use tax payment information should complete Form BOE-49, District Audit Request/DMV Search – Consumer Use Tax Section. To submit a request, send the completed BOE-49 as an email attachment to CUTS DMV Search for D/O Audits. If necessary, enter additional information or comments in the body of the email. The following Vehicle and/or Vessel information fields are mandatory fields:

- "Vehicle Identification Number (VIN) or Vessel Hull Identification Number (HIN)"
- "Date of Sale"

~~send their requests to CUTS with as many of the following as possible:~~

- ~~• Date of sale.~~
- ~~• Purchaser name and address.~~
- ~~• Complete Vehicle Identification Number (VIN) or Vessel Hull Number (CF#).~~
- ~~• Make and model.~~
- ~~• License plate, registration or CF number.~~

~~Auditors can send their audit worksheets with the above information and leave enough space next to each entry for CUTS to respond on the same document.~~ Due to the potential volume of requests, these requests should not be made on a routine basis. However, auditors are encouraged to request DMV information from CUTS whenever it is warranted and will assist in completing the audit.

Occasionally, a field auditor ~~will finds~~ that a seller under audit ~~will have~~has an existing CUTS determination. When determinations have been issued, these determinations or demand billings cannot be routinely canceled. If there is a discrepancy in the amount of determination, the auditor should advise CUTS by

**REQUESTS FOR DMV INFORMATION FROM  
CONSUMER USE TAX SECTION**

**(Cont.) 0606.15**

memorandum of the proper measure upon which the billing should be based. The key exception is if the transaction is subject to sales tax. The CUTS staff should be contacted to resolve the issue.

In instances where a determination has not been issued, CUTS staff will provide the auditor with information so that the account may be properly audited.

When a vehicle is sold by a person other than a licensed vehicle dealer, the applicable tax is generally the use tax, which the purchaser pays directly to the DMV at the time the vehicle is registered. However, when a vehicle is sold by a licensed dealer, the applicable tax is sales tax. As with other sales tax transactions, the sales tax is imposed upon the retailer, who may collect sales tax reimbursement from their customer.

There are instances where the person who holds a DMV dealer's license is not the same as the person holding the seller's permit. In such cases, the auditor must verify if the seller's permit holder is actively using the dealer's license to conduct business operations. Although the dealer's license is held in the name of another person, the BOE will regard a seller's permit holder who is actively using another person's DMV dealer's license to conduct business as the person licensed under the Vehicle Code as a dealer. By using the dealer's license of another person, the seller's permit holder is liable for the sales tax on vehicle sales pursuant to RTC section 6275(b).

As RTC section 6275(b) indicates, the person holding the dealer's license is liable for sales tax on vehicle sales made using his or her dealer's license; therefore, auditors should issue a dual determination in the name of the licensed vehicle dealer in addition to the seller's permit holder.

## USE OF DEALER'S REPORTS OF SALE BOOKS IN AUDITING GROSS RECEIPTS

0607.35

It is apparent from the preceding sections that an examination of some or all of the dealer's copies of Report of Sale (ROS) books can be of great value in auditing a dealer's records. In the examination, notations of self-registrations, sales to leasing companies, sales to out-of-state residents, and registration to other dealers should be made for reference in auditing self-consumed merchandise and deductions.

The auditor should verify that all ~~Report of Sale~~ROS books are available and have been accounted for in the taxpayer's records. Occasionally, the dealer's ROS books may not be available and must be obtained from DMV by the auditor. This may occur when DMV has secured the ROS books for audit or the dealer has ceased operations. In new car dealer audits, the information should be obtained from DMV only when poor records, loose internal control or other special circumstances warrant.

~~To obtain the serial numbers, year of issue, and total number of DMV Report of Sale Books issued to the dealer during the audit period, the auditor must call Vehicle dealer information, including ROS and Administrative Service Fee Report information, may be obtained from the DMV either by emailing the request to LODInfoReq@dmv.ca.gov or by calling the DMV's Occupational Licensing Information Service Voicemail at (916) 229-3151<sup>+</sup>. Auditors are encouraged to request information by email instead of telephone. Email allows an electronic record of such requests to be retained by BOE which should facilitate follow up requests, if necessary. At the end of the voicemail announcement, the auditor will be asked to leave a message, including the Board's requester code, information requested (include the dealer's name and the dealer's license number), the date the requested information is needed (i.e., start date of the audit) and the auditor's name, work phone number and district office address. (To skip the voicemail announcement, press the pound (#) key to leave a message.) Unless requested sooner, the DMV will provide the information requested within two weeks.~~

Auditors must provide the following information to DMV:

- Auditor's name
- Auditor's contact phone number
- Office mailing address
- BOE's DMV requester code
- Name and dealer's license number of the party for which information is being requested
- Specific information being requested
- Business reason for the request

Auditors should allow 7 - 10 business days for processing the requested information. DMV will provide the requested information via US Postal Service. To follow up on a request, the auditor may call the DMV at (916) 229-3127. Whether or not utilized in

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<sup>+</sup>~~As of February 8, 2006, the procedure on how to obtain information from the DMV is accurate. Any problems in contacting the DMV should be directed to the Tax Policy Division, Audit and Information Section.~~

## USE OF DEALER'S REPORTS OF SALE BOOKS IN AUDITING GROSS RECEIPTS

(Cont.) 0607.35

the audit, tThe information obtained from the DMV must be included in the audit working papers.

~~In new car dealer audits, the information should be obtained from DMV only when poor records, loose internal control or other special circumstances warrant.~~

~~Occasionally, dealer's Report of Sale books may not be available and must be obtained from DMV by the auditor. This may occur when DMV has secured the Report of Sale books for audit or the dealer has ceased operations.~~

## USE OF REPORTS OF SALE IN AUDITING USED CAR DEALERS

As noted in previous sections, used car dealers use the "Reports of Sale - Used Vehicle" (ROS) form to register used vehicles with the DMV. Auditors reconcile a used car dealer's ROS to verify reported taxable sales. The ROS is required to be filed with DMV on all retail used vehicle transactions. Thus, accounting for the ROS that DMV issued to a dealer is an important verification step when there is doubt about the accuracy of a dealer's reported sales.

The DMV, Occupational Licensing Branch, maintains an inventory of each ROS number issued to car dealers; however, the DMV does not maintain the ROS number after processing the registration. Since this information is not maintained, there is not a readily available way to compare a used car dealer's actual use of ROS with actual registrations to determine the number of unused ROS. Comparing the number of ROS issued to a dealer with the number of vehicle sales recorded in the dealer's records, plus the number on-hand, plus the number of "voids," and then considering the "missing" difference to be sales of vehicles is not necessarily accurate.

In such cases, additional or secondary audit techniques must be used and clearly documented as part of the audit report to support an estimated tax liability established by projecting the number of missing ROS forms. Audit Manual section 0407.05, *Specialized Techniques - Sales and Use Tax General*, provides other techniques the auditor may use to support the liability. These include: investigating bank deposits; gross profit and net worth analysis; income tax returns; or purchases plus a mark-up. Auditors should also consider touring the location of the business to ascertain whether the amounts being reported are reflective of the size of the business. One or more of these additional techniques must be used to support whether the missing ROS are in fact sales of used vehicles.

DAS maintains a database from DMV of vehicles registered by licensed dealers. The database contains the vehicle registration information by dealer number and provides the following:

- VIN (Vehicle Identification Number)
- License Plate
- Registered Owner
- Registered Owner's City
- Legal Owner (Lienholder)
- Legal Owner's Address
- Vehicle Registration Date
- Odometer Reading Date
- Transfer Date
- Vehicle Make, Type, Year
- Odometer Reading
- VLf (Vehicle License Fee) Code

DAS estimates the sale date by using odometer reading date or transfer date. Sales price is estimated by using the VLF measure. VLF measure is determined by the VLF Code on the vehicle registration and it is usually within \$199 of the actual selling price. The maximum measure used is \$96,400.

Some data errors should be expected since the vehicle registration data are keyed in by hand. DMV data can be validated by Consumer Use Tax Section (CUTS) and bill of sale and report of sale documents can be provided as needed. Your request should be sent via e-mail to *CUTS DMV Search for D/O Audits*. See AM section 0606.15 for more information on requesting DMV information from CUTS.

DMV Data requests should be sent to DAS via email to [DataReq@boe.ca.gov](mailto:DataReq@boe.ca.gov) with "DMV Data" in the subject line.

A salvage vehicle is one that has been wrecked or damaged, and the owner, insurance company, financial institution or leasing company considers it too expensive to repair. For example, in cases where the insurance company determines the vehicle is a "total loss salvage," it pays the owner the pre-collision value of the vehicle and forwards the certificate of ownership, the license plates and a required fee to the DMV. The DMV then issues a salvage certificate for the vehicle. The vehicle may subsequently be repaired and re-registered with the DMV. It is then classified as a "revived salvage" or "salvaged" vehicle.

When a person other than a licensed vehicle dealer sells a vehicle, the applicable tax is generally the use tax, which the purchaser pays directly to the DMV at the time the vehicle is registered. However, in regard to "salvage vehicles," Vehicle Code section 11519 provides that a vehicle with a salvage certificate may not be registered until the vehicle has passed specific safety inspections with the DMV and/or the California Highway Patrol. The sale of a vehicle with a salvage certificate that has not yet passed the required inspections is a sale of "rolling parts" rather than a sale of a vehicle required to be registered under the Vehicle Code. Therefore, the sales tax exemption provided by RTC section 6282 is not applicable and the sale of salvage certificate vehicles may be subject to the sales tax. As with other sales tax transactions, the sales tax is imposed upon the retailer, who may collect sales tax reimbursement from their customer.

In the event the retailer obtains the necessary safety inspections and obtains a revived salvage title prior to selling the vehicle, the vehicle is a vehicle that is required to be registered under the Vehicle Code. Accordingly, if the seller is not a licensed dealer, the applicable tax is a use tax which the purchaser pays directly to the DMV at the time of registration.

In situations where salvage certificate vehicles are purchased at an auto auction by a non-dealer (retailer) and are subsequently sold to the public, auditors must verify if the retailer is actively collecting and remitting the sales tax on these transactions. If not, auditors must assess the sales tax liability against the retailer of the salvage certificate vehicles, unless the sales are otherwise exempt from sales and use tax (e.g. sales for resale, sales in interstate and foreign commerce, etc.).

The measure of tax on the retailer's retail sale is the separately stated charge for the salvage certificate vehicle, including fees that are a part of the sale (e.g. finders fee, service fee, auction fee, agent fee, representative fee, brokerage fee, etc).

If there is no such separately stated charge, the measure of tax should be established based on:

- Available information on hand (e.g. calculate a mark-up based on available sales and purchase invoices and project the sales of salvage certificate vehicles),  
or
- Retailer's purchase price of the salvage certificate vehicles at auction plus a mark-up of 10 percent (10%).

CUTS staff is able to obtain copies of DMV documents related to a specific vehicle. Such documents are helpful when details regarding a vehicle are known, including VIN and/or license plate number, but where the sales price of the vehicle is in question. Documents available from DMV may include Registration Receipt, Certificate of Title (pink slip), Bill of Sale, Report of Sale, Statement of Fact, Power of Attorney, and other documents provided to DMV.

Pursuant to Audit Manual (AM) section 0606.15, the documents can be obtained by completing Form BOE-49, *District Audit Request/DMV Search – Consumer Use Tax Section* and sending it as an email attachment to *CUTS DMV Search for D/O Audits*.

Further, AM section 0606.15 provides that due to the potential volume of requests, these requests should not be made on a routine basis. However, auditors are encouraged to request such DMV documents from CUTS whenever it is warranted and will assist in completing an audit.

At the time of an audit, the retailer may contend that the purchasers of the salvage certificate vehicles have subsequently paid the tax directly to the DMV on the transactions that the retailer failed to collect and remit the sales tax. In these cases, the retailer should be given an opportunity to establish tax was paid by obtaining a statement from the purchaser utilizing the “XYZ” letter procedure outlined in AM section 0409.51. Forms BOE-504-BSV or BOE-504-BSV1 (for email response), *Sample “XYZ” Cover Letter for Salvaged Vehicles*, and BOE 504-CSV or BOE-CVS1 (for email response), *Statement Concerning Property Purchased Without Payment of California Sales Tax*, should be used to confirm tax was paid.

Pursuant to RTC section 6092.5, a sale of a mobilehome, commercial coach, or vehicle (including a salvage certificate vehicle) by a licensed auto dismantler, or by any person making such a sale at auction, is presumed to be a sale at retail. The seller may rebut this presumption by accepting a resale certificate in a form as prescribed in Regulation 1566.1 or Board form BOE-230-F from a licensed dealer, dismantler, automotive repair dealer, or scrap metal processor. The seller is prohibited from accepting a resale certificate for a vehicle, mobilehome, and commercial coach from any purchaser other than those mentioned. (See Regulation 1566.1, *Auto Auctions and Auto Dismantlers*, for additional information.)

- DMV’s Occupational License Status Information System: [www.dmv.ca.gov/oling2/welcome.do](http://www.dmv.ca.gov/oling2/welcome.do) – Provides information on type of dealer license held and owner information, and allows for searches by name, city, or dealer license number.
- Internet Search Engines: [www.google.com](http://www.google.com) and [www.yahoo.com](http://www.yahoo.com) - Used to search for articles or other information pertaining to a specific dealer.
- Car Dealer’s Website – Information may include details regarding inventory, types of vehicles for sale, business contact names, business history.
- Used Car Dealer News: [www.usedcarnews.com](http://www.usedcarnews.com) – General used car industry news, including profiles of specific vehicle dealers.
- Automotive Digest: [www.automotivedigest.com](http://www.automotivedigest.com) – Online magazine that provides automotive industry news, developments, and activities in the automotive industry published by major national and global print publications, magazines, wire services, Internet newsletters, and newspapers.
- The Autochannel: [www.theautochannel.com](http://www.theautochannel.com) – New and used vehicle information, link to classified ads section used by some used car dealers to advertise vehicles for sale.
- CA Motor Car Dealers Association: [www.cncda.org](http://www.cncda.org) – Association of franchised car dealers. Website provides industry data and publications, including “California Auto Outlook” bulletin, Economic Impact Reports, and news releases.
- NorCalCars: [www.norcalcars.com](http://www.norcalcars.com) - Small online auto mall, provides inventory information for some smaller independent used car dealers located in Northern California.
- Trade Express: [www.tradeexpress.com](http://www.tradeexpress.com) - Provides inventory information for some used and new car dealers located in Southern California.
- Auto Trader: [www.autotrader.com](http://www.autotrader.com) – Online classified ads, including ads placed by used car dealers.
- Bizstats: [www.bizstats.com](http://www.bizstats.com) - Small business statistics, including industry specific information such as inventory turnover rate, profit margin, etc.
- DMV Financial Institutions List: is an alphabetized listing of banks, credit unions and financial/lending institutions that provide vehicle loans in California.  
[https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv\\_content\\_en/dmv/about/lob/lob\\_top#faq](https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv_content_en/dmv/about/lob/lob_top#faq).
- National Independent Auto Dealers Association (NIADA): [www.niada.com](http://www.niada.com) – Trade website with information and links to auto auctions, trade publications, and other industry related news and information.
- Independent Automobile Dealers Association of California: [www.iadac.org](http://www.iadac.org) – California dealers' trade website with information and links to auto auctions, trade publications, and other industry and related news and information.