State of California

Board of Equalization
Business Tax and Fee Department

Memorandum

To : Mr. David J. Gau
Executive Director (MIC 73)

Date: October 5, 2016

From : Susanne Buehler, Deputy Director
Business Tax and Fee Department (MIC 43) Susanne Buehler

Subject : **Board Meeting October 25-26, 2016**
Item N: Administrative Agenda
Proposed Revisions to Compliance Policy and Procedures Manual (CPPM) Chapter 5, *Returns*, and Chapter 7, *Collections*; and Audit Manual (AM) Chapter 4, *General Audit Procedures*, Chapter 9, *Grocers*, and Chapter 12, *Construction Contractors*

I am requesting approval to forward the attached revisions to CPPM Chapters 5 and 7, and AM Chapters 4, 9 and 12, to the Board Proceedings Division to be placed as a consent item on the Administrative Agenda at the October 2016 meeting. The proposed revisions incorporate current policies and procedures.

These revisions have been reviewed and approved by Business Tax and Fee Department and Field Operations 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. We received a minor correction to CPPM section 540.070 and AM section 0401.05, regarding the correct BOE departments that can credit overpaid prepayments to subsequent tax returns. No other comments were received from Board Members or other interested parties.

If you have any questions, please let me know or contact Ms. Lynn Whitaker at 916-324-8483.

SB:ljm

Attachment

Approved:

David J. Gau

Mr. David J. Gau
Executive Director

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the October 25, 2016 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

cc: (all with attachment)
Mr. Wayne Mashihara (MIC 47)
Chief, Tax Policy Division (MIC 92)
Ms. Debra Kalfsbeek (MIC 62)
Mr. Richard Parrott (MIC 57)
Mr. Kevin Hanks (MIC 49)
Mr. John Thiella (MIC 73)
Mr. Marc Alviso (MIC 73)
Mr. Chris Lee (MIC 73)
Ms. Leila Hellmuth (MIC 43)

OVERPAID RETURNS 540.070

A return which has definitely been found to ~~be overpaid~~include an overpayment will be identified with the total amount of remittance, a check mark and the letters "OP" entered just below the space provided for "Total Amount Due and Payable." See Exhibit 2.

Taxpayers generally should not claim a deduction on a current return to adjust for an overpayment reported on a prior return. The correct procedure is to file a claim for refund for the overpayment. For more information on allowable return adjustments for prior overpayments, see Audit Manual section 0401.05

Only in the very limited circumstances where a taxpayer makes an unintentional overpayment of prepayments on their tax return may the resulting credit be applied to a subsequent return. Only Return Analysis Unit (RAU) and the Appeals and Data Analysis Branch (ADAB) are authorized to approve this procedure.

BUSINESS CONVERSIONS, MERGERS, AND ACQUISITIONS 726.033

~~Limited partnerships and limited liability companies may convert into an "other" business entity (defined to include a corporation, business trust, and real estate investment trust) or a foreign limited partnership or foreign limited liability company, under certain conditions. In addition, corporations have the ability to "merge" into an "other" business entity, defined to mean a domestic or foreign general partnership, limited partnership, limited liability company, business trust, real estate investment trust, unincorporated association (other than a non-profit association), or a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance. A merger involves two or more entities while a conversion involves only one. In a merger, one entity is absorbed by another so that the assets, debts, obligations, etc., of the disappearing entity are transferred to and become part of the combined assets, debts, and obligations of the surviving entity. In a conversion, the entity that converts into another is for all purposes the same entity that existed before the conversion, except that the form of business organization (and possibly the name) has changed. In both cases, the law stipulates that the debts and obligations of the former entity become the debts and obligations of the new or surviving entity. Since the debts and obligations of the former entity become the debts and obligations of the converted or merged entity, it is inappropriate to issue successor billings or dual determinations to transfer or replicate a liability established against the former entity to the converted entity. By operation of law, these merged or converted entities are not entitled to the statutory 30-day petition rights accorded rightful dualees or successors. Instead, a demand billing will be sent to the surviving or converted entity for payment of the liability incurred by the former entity, with conversion information and appropriate reference to the origin of the liability included. This also applies to billing to a surviving corporation in a statutory corporate merger. If a conversion billing needs to be sent to a converted entity, a memo or e-mail request should be sent to SPS with all pertinent information included such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation and information sources, etc. Any other evidence, such as written statements or documents should also be forwarded.~~

OVERVIEW

There are various forms of business entities recognized in California. They are: corporations, partnerships, limited partnerships, limited liability companies (LLCs), and limited liability partnerships. As discussed below, the first four entity forms can participate in various transactions that may affect their status, including merger, conversion, and acquisition, all as provided in the California Corporations Code (CCC). Limited liability partnerships, however, are precluded from some such transactions. (There are also sole proprietorships, the treatment of which is discussed below.) A merger involves two or more entities while a conversion involves only one. A merger, or merger reorganization, is the absorption of one entity by another that survives, retains its name and identity, together with the added capital, franchises and powers of the merged (or disappearing) entity, and continues the combined business. The merged entity ceases to exist and the merging entity alone survives. Thus, the surviving entity acquires all rights and property of the disappearing entity and is subject to all debts and liabilities of the disappearing entity (as if the surviving entity had itself incurred them).

In a conversion, the entity that converts into another is, for all purposes, the same entity that existed before the conversion, except that the form of business organization (and possibly the name) has changed. In both cases, the debts and obligations of the former entity become the debts and obligations of the new or surviving entity. A limited liability partnership, however, is precluded from converting into another form of business entity.

Since the debts and obligations of the former entity become the debts and obligations of the converted or merged entity, it is inappropriate to issue successor billings or dual determinations to transfer or replicate a liability established against the former entity to the converted or merged entity. If the liability of the disappearing entity has gone final, these merged or converted entities are not entitled to the statutory 30-day petition rights accorded rightful dualees or successors. Instead, a demand billing (that includes information regarding the conversion and a reference to the origin of the liability) will be sent to the surviving or converted entity for payment of the liability incurred by the former entity. If a demand billing needs to be sent to a converted entity, a memo or e-mail request should be sent to the Special Operations Branch (SOB) with all pertinent information included such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation and information sources, etc. Any other evidence, such as written statements or documents should also be forwarded.

There are also two types of acquisitions. One involves the acquisition of the shares of a stock of a corporation (also known as an "exchange reorganization"), and the other involves the acquisition of the assets of a corporation (a "sale-of-assets reorganization"). Thus, when one person or entity acquires all of a corporation's shares of stock from others, the corporate form remains intact, and only the shareholders have changed. The corporation has been acquired by new owners, but it retains its identity. Therefore, if the corporation holds a seller's permit with the BOE, that permit should continue in the corporation's name. Alternatively, in the case of a "sale-of-assets reorganization," when any form of business sells its assets (as opposed to sale of its shares or membership interests), the provisions of Revenue and Taxation Code (RTC) sections 6811-6814 and Regulation 1702 may be triggered, leading to the issuance of a successor determination. Specific types of each of these transactions (along with instructions for registration and billing requests once a transaction has occurred) are discussed below.

STATUTORY MERGERS

Statutory mergers follow the provisions set forth in the CCC for the given type of entity. For a merger to be valid, the merged entities must have followed the requirements set forth in the CCC.

Statutory provisions governing merger reorganization for corporations are set forth in the CCC, Chapter 11, and specify the statutory legal formalities required to merge a corporation with another corporation or other business entity in California. Two or more corporations may be merged into one of those corporations. The board of each corporation seeking to be merged must approve an agreement of merger. As set forth in section 1107(a) of the CCC, once a statutory merger has occurred, the merged or disappearing corporation no longer exists and the surviving corporation succeeds to all the rights and property of the disappearing corporation and is subject to all of the

debts and liabilities of the disappearing corporation (as if the surviving corporation had itself incurred them).

Mergers of limited partnerships are authorized pursuant to section 15911.10 of the CCC. Mergers of partnerships are authorized pursuant to section 16910. Mergers of LLCs are authorized by section 17710.10. With respect to mergers of each of these forms of entity, the surviving entities are subject to debts and liabilities of the disappearing entity, as if the surviving entity had incurred them.

There is no authority for mergers of limited liability partnerships.

Another type of statutory merger is called "short-form merger," which is a merger of a parent corporation with one or more wholly owned subsidiaries, or the merger of a parent corporation and one or more subsidiaries of which the parent corporation owns at least 90%, but not all, of the outstanding shares of each class.

Registration for Mergers

In a statutory merger, the merged corporation ceases to exist. BOE staff should close out the BOE account(s) of the disappearing corporation and document that the accounts were merged into the surviving corporation and its BOE account(s).

CONVERSIONS

Conversions of corporations are governed by sections 1150-1160 of the CCC. In a conversion, the entity that converts into another is, for all purposes, the same entity that existed before the conversion, except that the form of business organization (and possibly the name) has changed. A corporation may be converted into a "domestic other business entity" if the shares of the converting corporation are treated in conformity with CCC section 1151 in that: (1) each share of the same class of the converting corporation is treated equally with respect to any cash, right, securities or other property to be received and (2) nonredeemable common shares of the converting corporation are converted into non-redeemable equity securities of the converted entity. An entity in California that wishes to convert to another domestic entity must approve a plan of conversion that states all of the following:

- The terms and conditions of the conversion.
- The jurisdiction of the organization of the converted entity and of the converting corporation and the name of the converted entity after conversion.
- The manner of converting the shares of each of the shareholders of the converting corporation into securities of, or interests in, the converted entity.
- The provisions of the governing documents for the converted entity, including the partnership agreement or LLC articles of organization and operating agreement, to which the holders of interests in the converted entity are to be bound.
- Any other details or provisions that are required by the laws under which the converted entity is organized, or that are desired by the converting corporation.

Conversions of limited partnerships are authorized pursuant to CCC section 15911.02. However, a limited partnership may not convert to a limited liability partnership (CCC section 16955). Conversions of general partnerships are authorized pursuant to CCC section 16902. Conversions of LLCs are authorized by CCC section 17710.02. With respect to conversions of each of these forms of entity, the converted

entities are subject to all debts and liabilities of the converting entity, as if the converting entity had incurred them.

There is no authority for conversions of limited liability partnerships.

Registration for Conversions

In this type of situation, it is not necessary to close out the account(s) of the converting entity and issue a new account(s). The name of the entity and type of business may need to be changed on the account(s).

If a sole proprietor decides to incorporate or form some other type of business entity (such as a partnership, limited partnership, or LLC), that is not a conversion. Staff should close out the account(s) of the sole proprietor and issue a new account(s) to the new entity. There would be no question of the liability of the individual for taxes and/or fees owed prior to the incorporation. The liability of the individual owner(s) for the subsequent liabilities of the new entity would be subject to the BOE's rules as set forth in RTC section 6829 or RTC section 6071.1 (a) and (b).

Conversions - Administrative Fees for Cigarette Licensees

Under the Cigarette and Tobacco Licensing Act of 2003, cigarette manufacturers and importers are required to pay an administrative fee when they begin operations in the state. In cases where a corporation undergoes a conversion, the entity would not be required to pay an administrative fee. Conversely, if a sole proprietor incorporated, or formed an LLC or other form of business entity, the resulting corporation or other form of entity would be required to obtain a new Cigarette and Tobacco Products License and pay an administrative fee when it begins operations in this state.

BILLING REQUESTS FOR STATUTORY MERGERS AND CONVERSIONS

To request a demand billing to a merged or converted entity, a memorandum should be sent to SOB. The request must indicate the status (final or non-final) of the underlying liability. An open petition or appeal of one or more of the disappearing entities must be respected. In such case, rather than issue a demand billing, SOB will send the new entity a Statement of Account with specific bill notes and notify the Petitions Section who will add or substitute the surviving entity in place of the disappearing entity during the petition or appeal process.

Along with the status of the underlying liability, the request should include all pertinent information such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation and information sources, etc. Any other evidence, such as written statements or documents, should also be forwarded.

DE FACTO MERGERS

A more difficult issue arises when one entity has effectively shut down without formally dissolving, and the owner has formed a new entity, doing the same business in the same location. There is no formal merger and no contract of sale that would support a successor liability billing.[1] If the facts have been sufficiently investigated and certain conditions are present, the BOE may be able to assert that there has been

[1] Statutes for successor's liability exist under the Sales and Use Tax Law , Motor Vehicle Fuel Tax Law, Use Fuel Tax Law, Oil Spill Response, Prevention, and Administrative Fees Law and Diesel Fuel Tax Law. There are no statutory provisions for successor's liability for other tax and fee programs administered by the BOE.

a "de facto" merger and that the new entity should be billed as a "mere continuation" of the former entity. The following elements must be present to determine that there has been a de facto merger:

Elements of a De Facto Merger

1. Transfer of substantially all of the business assets of the former entity to the new entity;
2. Substantial alignment of ownership and/or control of the new and old entities (are the owners and managers of both entities substantially similar?);
3. Absence of meaningful consideration paid by the new entity for the assets of the former entity;
4. Evidence that the new entity is merely continuing the business of the former entity, such as: using a substantially similar business name, using the same business location, maintaining the same vendor accounts who supply to the new entity, using the same phone number, and having the same employees; and
5. The absence of evidence that the former entity formally dissolved, filed appropriate documentation with SOS and wrapped up its affairs.

Before taking steps such as registration of the new entity under a de facto merger theory, or submitting billing requests for the new entity, a dual determination under RTC section 6829 must have been explored. The BOE may not issue a de facto billing until after a dual determination under RTC section 6829 has been issued, or until after the BOE has determined that the requisite elements for a section 6829 dual determination are not present.

Registration for De Facto Mergers

In this type of situation, BOE staff should close out the account(s) of the shut-down entity and issue a new account(s) for the new entity. If the new entity is not willing to self-register, an arbitrary permit number can be issued in order to complete the registration. The registration activities should be performed based on the results of the BOE investigation activities.

Billing Requests for De Facto Mergers

A demand billing for a liability that is final can be issued to the surviving entity for payment of the liability incurred by the former entity. As with all requests for demand billings, the request must state the status of the underlying liability. An open petition or appeal of one or more of the disappearing entities must be respected. In such case, rather than issue a demand billing, SOB will send the new entity a Statement of Account with specific bill notes and notify the Petitions Section who will add or substitute the surviving entity in place of the disappearing entity during the petition or appeal process.

The request must include all pertinent information such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation and information sources, etc. However, in order to pursue a de facto merger, all five elements of a de facto merger must also be present and clearly documented in the request. Send requests for demand billings to SOB who will consult with the Litigation Division before the request is approved.

Statute of Limitations for Mergers and Conversions

There is no specific statute that limits a conversion, merger, or de facto merger billing of a secondary entity for the liability of a primary entity. The doctrine of laches may apply in these cases where there is no statute. The doctrine affords a taxpayer an equitable defense if the BOE's billing was unreasonably delayed. Therefore, the BOE's policy is to issue the conversion, merger, or de facto merger billing within three years of acquiring knowledge of the facts supporting the secondary billing.

ACQUISITIONS

Acquisitions are a form of reorganization, and are covered in subdivisions (b) and (c) of section 181 of the CCC. Persons or entities can make acquisitions of all the forms of business entities discussed previously in the Overview part of this section. It is important to distinguish between a situation involving the acquisition of the equity securities of an entity, such as shares of stock of a corporation, a partnership interest of a general partnership, or membership interests of an LLC (also known as an "exchange reorganization"), and the acquisition of the assets of an entity (a "sale-of-assets reorganization"). The two types of acquisitions are described below.

Acquisition of Equity Securities / Exchange Reorganization

When one person or entity acquires some or all of an entity's equity securities from others, the form of the entity remains intact, and only the shareholders or owners have changed. The entity has been acquired by new owners, in whole or in part, but retains its identity. If it holds accounts(s) with the BOE, the account(s) should continue with the same name. The acquisition of an entity through exchange reorganization does not trigger successor liability. The sale of equity securities of an entity, including membership interests of an LLC, is not a transfer of ownership of physical assets for a financial consideration. Any liability of the entity that existed before the exchange reorganization remains a liability after such a transaction. There is no "disappearing entity" and no "surviving entity," therefore, there is no billing.

Registration for Acquisition of Equity Securities

In this type of situation, the entity continues to exist. It is not necessary to close out the account(s) of the entity and issue new account(s). Depending on the responsibility of the person acquiring the equity securities, the names of the persons acquiring the interest in the entity (such as partnership shares in a general partnership or a new CEO of a corporation) may need to be added to the account in the same manner as if such purchaser was one of the owners at the time the entity was originally registered as provided in Chapter 2 of this CPPM.

Acquisition of Assets / Sale-of-Assets Reorganization

In the case of a sale-of-assets reorganization, when any form of business sells its assets, the appropriate provisions for successor's liability under the RTC and the appropriate regulations may be triggered, leading to the issuance of a successor determination. The BOE can bill the acquiring entity if it can establish that the requisite elements of a successor liability are present. The purchaser is personally liable for the payment of the amount required to be withheld by him or her to the extent of the purchase price. A contract that evidences the purchase and sale of a business or stock of goods will support the successor billing.

Registration for Assets/Sale-of-Assets Reorganization

Staff must determine if the entity whose assets were acquired has actually closed. All locations of the "selling" entity must be closed before closing out its account(s). Staff should issue new account(s) to the entity that acquired the assets.

Billing Requests When There is an Acquisition

If the elements of a successor liability are present, the acquiring entity can be billed as a successor. See CPPM section 732.000 for more information.

NOTIFICATION OF REGISTRATION CHANGES

Information concerning updates to registration due to mergers, acquisitions or conversions may come from the tax or fee payer through written correspondence, investigation, or communication by telephone or e-mail with the account holder or its representative. Regardless of whether a liability exists, upon notification of a merger, acquisition or conversion, staff receiving the information should verify the status of the old and new entities via the "Business Search" function available on the Secretary of State's (SOS) website located at http://kepler.sos.ca.gov.

Since the entity may be registered for multiple programs with the BOE, staff making the discovery of the merger, acquisition or conversion, should check for other related accounts in IRIS. In the event staff discover other BOE accounts that are affected by the merger, acquisition or conversion but the accounts/programs are not under their jurisdiction (based on tax or fee program), they should prepare a memo for their District Principal Compliance Supervisor (or equivalent for Special Taxes and Fees programs) containing the following elements:

a. BOE account number(s) and TIN affected.
b. SOS number (existing if applicable and new) affected by change.
c. Type of change (merger, de facto merger, conversion, sole proprietor to corporate change, acquisition of equity securities, acquisition of assets).
d. Effective date of change.
e. Action taken on BOE account(s) administered by discovering jurisdiction.
f. New BOE account number(s) and TIN established if applicable.

The District Principal Compliance Supervisor (or equivalent for Special Taxes and Fees programs) overseeing the area that discovered the merger, acquisition, or conversion should forward the aforementioned information and documents used to verify the information to the District Principal Compliance Supervisor (or equivalent for Special Taxes and Fees programs) responsible for overseeing registration activities outside their jurisdiction (based on tax or fee program) requiring potential account updates.

JEOPARDY DETERMINATIONS

If staff determines the facts showing that the secondary entity is concealing or otherwise disposing of its assets, the BOE could issue a jeopardy determination, which would have the effect of rendering that entity's liability final (see CPPM section 764.020 for information on jeopardy determinations). The mere creation of the secondary entity and the cessation of business by the primary entity, however, do not alone justify use of a jeopardy determination. A jeopardy determination is reserved for those cases where assets are truly in danger of being immediately hidden, moved, or otherwise disposed of.

COURT-ORDERED RESTITUTION 740.290

Restitution is defined as the act of making whole or giving the equivalent for any loss, damage, or injury. The purpose of restitution is to help victims recover from any financial hardship caused by a criminal activity.

A **restitution order** is a court order directed to the taxpayer requiring the payment of restitution (monetary payment), generally as a condition of probation or parole in a criminal case. The court issues a restitution order to cover the economic loss or actual crime-related expenses incurred by a victim as a result of a crime.

Under state law, offenders convicted of a felony or misdemeanor in California may be required to pay a fine, penalty, and the cost of investigation, in addition to an amount for restitution. If the defendant is on formal probation, payments may be made to the county where the crime/offense occurred. If the payment is directed to the county, the designated county is responsible for dividing the total funds received and forwarding the BOE's portion to the appropriate BOE office.

The stipulated final judgment documents **may** specify how the restitution payments are allocated between taxes, fines, penalties, and cost of investigations. When the stipulated final judgment documents do not provide specific information regarding the allocation of payments, the Investigations Division (ID) must review the criminal complaint and determine the amounts and periods to designate as restitution and whether any portion of the restitution is already billed. When any of the seized funds are provided to BOE, ID will determine how to apply any monies received toward the restitution periods.

Restitution payments ordered by the court on behalf of the BOE may be for less than the full amount of the civil liability (e.g., audit billing) owed by the taxpayer to the BOE. In this situation, the taxpayer remains liable for the full amount of the civil liability.

The passage of Assembly Bill 242, filed with the Secretary of State on October 9, 2011, and made effective on January 1, 2012, allows the BOE to collect on restitution orders in the same manner as other collections. Special Operations Branch (SOB) will monitor accounts in ACMS/IRIS that have active court-ordered restitution and are currently on probation, parole, or diversion; however, the control of the accounts will remain assigned to the Field Operations Department (FOD), or the Business Tax and Fee Department (BTFD) and will not transfer out of their assigned state in ACMS. The assigned collector will continue to work any additional liabilities and/or delinquencies and take the necessary collection action.

The collection of restitution by the court is a continuation of a criminal court action and therefore excepted (excluded) from the automatic stay provisions of the bankruptcy code (11 USC 362(b)(1)). However, if the court relies on BOE to collect the restitution due, the automatic stay does apply, and BOE cannot collect until the bankruptcy case is dismissed, or the BOE obtains leave from the court to collect while the stay is in place.

Payments required by a restitution order may continue to be due, even after a taxpayer's probation has ended.

ID's Responsibilities:

Document the information from the court-ordered restitution in ACMS for sales and use tax accounts and IRIS for special taxes and fees accounts.

Obtain and forward the restitution orders or information from the court to SOB for monitoring while the taxpayer is on probation, parole, or diversion. A copy of the restitution order will be attached to a formal memorandum to SOB with the following information:

- ID's restitution summary form.
- Copies of ID's executive summary (when applicable) and all court documents detailing the sentencing, restitution, terms, and requirements during the probation period.

File a court motion to:

- Modify restitution orders that are in default,
- Request an extension of probation,
- Request an increase in court-ordered restitution payments

Attend court hearings as referred by the field office on restitution cases.

Prepare a memo to FOD or BTFD when collection of the restitution order is paid in full, or the taxpayer's probation or parole has ended and the restitution has not been fully satisfied. The memo should include the most recent contact information available, and any additional notes or materials gathered by SOB while they were monitoring the case.

Provide quarterly reports to the Deputy Director, FOD and BTFD of those restitution cases that are being monitored by ID or SOB.

In the case of a Revenue and Taxation Code (RTC) section 6071 misdemeanor citation (operating with a revoked permit) where the taxpayer does not appear for a court hearing, a bench warrant is typically issued. If a bench warrant is issued, ID should attempt to have the taxpayer arrested or brought before the local District Attorney's office.

SOB, Liens and Specialized Collections Section's Responsibilities:

Monitor all active court-ordered restitution and fines for FOD and BTFD during the period the taxpayer is on probation, parole, or diversion. SOB will also monitor individual partners and corporate officers that were ordered to pay restitution on behalf of the partnership or corporation while the individual is on probation, parole, or diversion. SOB will perform the following duties:

- Coordinate with FOD or BTFD to establish an account number for court-ordered restitution and create a restitution period.
- Ensure restitution payments are applied appropriately.
- Create the unbilled cost of collection assessment for sales and use tax accounts on IRIS to track and monitor restitution payments. (Special Taxes Return Processing Branch personnel will create their own unbilled differences.)
- Cancel the unbilled cost of collection as soon as the restitution amount is billed.
- Make the necessary payment adjustments for restitution payments during the probation, parole, or diversion period.

- Prepare a memorandum to ID indicating whether restitution was or was not satisfied when the taxpayer's probation, parole, or diversion ended.
- Provide ID quarterly reports on active restitution cases.

Document in ACMS/IRIS:

- Receipt of the restitution order from ID and the terms of the restitution.
- Receipt and adjustment of restitution payments.
- Whether restitution is or is not satisfied when the probation period ended.
- Actions taken if restitution payments are not made.
- Contacts made with the assigned probation or parole officer, County's Revenue Department, ID, FOD, or BTFD.

SOB, Specialized Audit Section's Responsibilities:

Initiate RTC section 6829 dual determinations for sales and use tax liabilities in cases where a responsible person was ordered to pay restitution on behalf of a business that was terminated. The request to issue an RTC section 6829 dual determination will be forwarded by SOB to the Audit Determination and Refund Section for processing.

Coordinate with the impacted program area to create arbitrary accounts for corporate officers or other persons who are ordered to pay restitution by the court when an RTC section 6829 dual determination cannot be established.

Coordinate with the impacted program area to create arbitrary accounts for individual partners affected by the Revised Uniform Partnership Act where the court ordered the individual to pay restitution.

Cashier Section's Responsibilities:

Receive the payments and identifying documentation directly from the taxpayer or county. The check will be processed and the amount keyed into IRIS.

Any supporting documentation along with a copy of the payment will be forwarded to SOB, Liens and Specialized Collection Section, to determine the proper payment application.

Special Taxes and Fees Account Billings

Upon completion of the prosecution an account is created. The Return Processing Branch (RPB) will receive the referral memo from ID. RPB will review the court case provided by ID and request an account to be created (if needed) by the Registration and Licensing Section. RPB also determines the amount to be billed including any penalties or interest and establishes a billing on the account pursuant to RTC sections 30483 or 60709. Since the restitution is considered "final" by court decree, the billing created in IRIS is considered 'final' and collectable when the restitution is established on BOE records.

The court-ordered restitution is applicable to Taxable Activity Types (TATs) CR, CP, LR(Q), LD(Q), and LW(Q). RPB will establish the bill using the following information;

- Difference type EAB (external agency billing)
- Difference activity type COR (court-ordered restitution)
- Notice type DER (demand court-ordered restitution)
- FO type OTB (one time billing)

A statement will then be sent to the taxpayer at their listed address by first class U.S. Mail. Once the billing is established in IRIS, it will migrate to ACMS and be routed to the collector as directed by ACMS routing rules.

Collections:

RTC sections 7157 (sales and use tax), 8407 (motor vehicle fuel taxes), 30483 (cigarette and tobacco products taxes), and 60709 (diesel fuel taxes) allow restitution orders, or any other amounts imposed by a court of competent jurisdiction, for criminal offenses upon a person or any other entity. These amounts are due and payable to the BOE and may be collected by the BOE in any manner provided by law for the collection of a delinquent tax liability.

The following points apply to restitutions and amounts due before, on, or after January 1, 2012:

- They are treated as final and due;
- Refund or credit is not allowed;
- Interest may accrue on amounts due;
- They are not subject to statute of limitations;
- State tax lien may be filed.

FOD collection staff should work directly with ID staff to set the taxpayer on a monthly payment plan equal to the total restitution/cost of investigations awarded divided by the length of probation, parole, or diversion. An exception will be made for cases where the payment plan has been set by the court or where the taxpayer has submitted documentation supporting a financial hardship, in which case a review of the financial documents will be used to set the monthly payment amount. (See CPPM section 770.000.) If notified by SOB, collection action should be taken if the taxpayer is in default of the probation, parole or diversion terms.

The BOE may consider offer in compromise requests submitted by taxpayers owing court-ordered restitution, provided the amount of the offer includes the unpaid restitution amount.

RESTITUTION ORDER TO FEDERAL AGENCY

In cases where a taxpayer is ordered to make restitution payments to a federal agency, a case referral should be submitted to ID with the following:

- ID's restitution summary form, and
- Copies of ID's executive summary (when applicable) and all court documents detailing the sentencing, restitution, terms, and requirements during the probation period.

After ID reviews the referral, they will forward it to SOB to consult with the Litigation Division to determine if collection action may be taken.

AUDIT MANUAL CHAPTER 4,
GENERAL AUDIT PROCEDURES

TAX AUDITING **0401.05**

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Return Adjustments for Prior Overpayments

Taxpayers generally should not claim a deduction on a current return to adjust for an overpayment reported on a prior return. The correct procedure is to file a claim for refund for the overpayment. Nevertheless, under certain circumstances, a taxpayer may be entitled to claim a tax paid purchases resold, returned merchandise, or bad debt deduction in a later reporting period.

Only in very limited circumstances where a taxpayer makes an unintentional overpayment of prepayments on their tax return may the resulting credit be applied to a subsequent return. Only the Return Analysis Unit (RAU) and the Appeals and Data Analysis Branch (ADAB) are authorized to approve this procedure.

RTC section 6904 and equivalent special taxes and fees statutes require every claim for refund be in writing and state the specific grounds for the claim. RTC section 6905 and equivalent special taxes and fees statutes further provide that failure to file a timely claim for refund constitutes a waiver of any demand against the state for the overpayment. In a situation where a taxpayer erroneously overpays the BOE, a claim for refund must be filed with the BOE. This can be especially critical for taxpayers whose records are later audited. The following example illustrates the problems that can result from a taxpayer taking this kind of self-help deduction instead of filing a timely claim for refund.

> ABC Corporation (ABC) overpaid use tax on its third quarter 2012 return for a fixed asset purchase. The error was discovered in mid-2013. ABC reduced the taxable amount reported on its second quarter 2013 return by the overstated fixed asset purchase amount. ABC did not file a claim for refund.
>
> During a subsequent audit of ABC's records, the deduction claimed on the second quarter 2013 return was disallowed. The overpayment should have been claimed by ABC filing an amended third quarter 2012 return and timely filing a claim for refund. By the time the error was discovered, the statute of limitations for filing a timely claim for refund for the third quarter 2012 overpayment had expired, and the amount disallowed for the second quarter 2013 was correctly assessed in the audit. If the error is discovered past the statute date allowed for the claim for refund, the taxpayer has no further recourse.

. . . . . .

MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT 0422.25

Revenue and Taxation Code (RTC) section 6377.1 (see also Regulation 1525.4, *Manufacturing and Research & Development Equipment*) provides a partial sales and use tax exemption for the sale or purchase of: (1) qualified tangible personal property; (2) purchased for use primarily in manufacturing or research and development; (3) by a qualified person. See the regulation for specific definitions and more detailed information with respect to the three requirements to qualify.

The partial exemption applies to qualifying sales to and/or purchases by a qualified person made on or after July 1, 2014 and before July 1, 2022. To be considered a "qualified person" for the partial exemption, the business's North American Industry Classification System (NAICS) code, based on the 2012 edition published by the United States Office of Management and Budget, must fall within any code from 311100 to 339999 for manufacturers, or it must be 541711 or 541712 if engaged in research and development. The legislation limits the allowable exemption to $200 million in qualifying purchases each calendar year for each qualified person.

If a taxpayer does not know which NAICS code or industry group accurately describes their business activities, they may seek assistance on the United States Census Bureau's website where they can either search for codes, or email the Census Bureau directly with specific questions, or both.

Retailers

Retailers are required to obtain a timely partial exemption certificate from the purchaser to support a deduction for equipment purchased for use in manufacturing or research and development. The retailer must retain in its records the partial exemption certificate obtained from the purchaser; otherwise, the partial exemption will not be allowed. A seller who timely and in good faith accepts a certificate containing the necessary elements is relieved of liability for the sales tax subject to exemption or the duty to collect the use tax subject to exemption. A seller will be presumed to have taken the partial exemption certificate in good faith in the absence of evidence to the contrary.

Purchasers and Partial Exemption Certificates

Qualified persons who purchase equipment to be used in manufacturing or research and development must issue a partial exemption certificate to the retailer to allow the retailer to claim the partial exemption. The purchaser may use form BOE-230-M, *Partial Exemption Certificate for Manufacturing, Research and Development Equipment*.

Construction Contractors

See AM Chapter 12, *Construction Contractors*, section 1208.60, for information on qualifying purchases and/or sales by a construction contractor.

Audit Procedures

As noted above, the partial exemption has an annual cap, limiting the amount of purchases subject to the partial exemption that can be claimed in a calendar year to $200 million per qualified person. Audit staff is responsible for verifying that qualified purchasers (those described in NAICS codes 311100 to 339999, 541711, and 541712), have not exceeded the $200 million cap.

Retailers: Audit staff should verify that partial exemption certificates have been obtained for all claimed partial exemptions. General ledger sales to customers in California should be examined and reviewed on an actual basis to identify taxpayers making significant purchases. If the retailer has significant sales to an individual taxpayer that the auditor believes may cause the purchaser to exceed the $200 million annual purchase limit, a BOE-1164, *Audit Memorandum of Possible Tax Liability* should be sent to the district of the purchaser.

Qualified Persons. A qualified person means a person who is primarily engaged (50 percent or more of the time) in a qualified line of business either as a legal entity or as an establishment within a legal entity. See Regulation 1525.4(b)(8)(A) for a detailed definition of a qualified person.

A purchaser is not precluded from being a qualified person when there is no applicable six digit NAICS code to describe their line of business, provided their business activities are reasonably described in a qualified four digit industry group. For example, a business in the recycling industry may be regarded as a qualified person when the activities of the establishment are reasonably described in a qualified four digit industry group.

Purchasers. Audit staff should review capital asset purchases and verify tax rates paid on purchases. When incorrect tax rates are found, further review of transactions should be done on an actual basis. Staff should follow the standard audit procedures to pick up differences or have the taxpayer file a claim for refund where necessary. See Exhibit 20 for information on how to select the proper Juris Grid code in the audit upload.

Preparing Audits for Uploads

Start 21 Program – BOE Audit Program

1) The noncompliance code template (414N Code tab) includes three new noncompliance codes:
   - 3001 – Exemption Not Claimed
   - 3002 – Exemption Over Claimed
   - 3003 – Exemption Under Claimed

2) The Juris Grid was updated to add fund code LRF (904) to the grid. Exhibit 20 displays some possible audit scenarios that might be encountered, demonstrating the proper way to indicate the error in the linking worksheet.

Exemption Limitation

Qualified persons cannot claim more than $200 million in qualifying purchases subject to the partial exemption each calendar year. Persons may make purchases and issue partial exemption certificates with the intention of qualifying for the partial exemption in the one year period following the date of purchase. If a purchaser issues a partial exemption certificate to the seller and later discovers they exceeded the annual cap or the purchase does not qualify for the partial exemption, the purchaser is liable for the difference to equal the full payment of sales tax plus applicable interest as if the purchaser were a retailer making the sale at the date of purchase.

To report the tax difference, the taxpayer must report the amount of their over claimed purchases on their sales and use tax return for the period the purchases were made. The taxpayer reports the amount of their over claimed purchases as a negative entry on the return line, *Sales Made Subject to the Manufacturing and Research and Development Equipment Exemption.* If the taxpayer is reporting other transactions on this line that are subject to the partial sales and use tax exemption (for example, qualifying sales to another qualified person), then the taxpayer should net the over claimed purchase amount from those transactions and report the total net amount.

If the taxpayer does not hold a seller's permit, they have to register for a Consumer Use Tax Account to report and pay the tax difference on a Consumer Use Tax Return. These payments will create a return edit and the allocation to the proper accounts will have to be processed by the Return Analysis Unit and the Local Revenue Branch.

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DEAL-OF-THE-DAY INSTRUMENTS 0437.30

This AM section provides guidance on the application of tax to sales of tangible personal property when all or part of the consideration paid by the purchaser consists of a deal-of-the-day instrument (DDI). DDIs are offered for sale by third-party, Internet-based companies (for example, Groupon or LivingSocial) on their websites as "deals-of-the-day." The deal-of-the-day features a DDI that can be redeemed for merchandise or services at local or national retailers. Customers purchase the DDI on-line which allows them to purchase a set amount of products and/or services from the participating retailer.

DDIs can be broken down into two component parts, and depending on the retailer, different terms and conditions may apply to each of the two component parts. We refer to the two component parts of a DDI as the "paid value" and the "promotional value." The "paid value" is the advertised selling price of the DDI (i.e., the amount the customer pays for the DDI) as provided in the contract between the retailer and the DDI provider (third-party, Internet-based company). The amount the customer pays for the DDI is less than the advertised face value of the DDI. Therefore, the "promotional value" is the value in excess of the amount paid (i.e., the difference between the face value of the DDI and the paid value).

DDI General Terms and Conditions

The following terms and conditions are generally applicable to all deal-of-the-day transactions:

1. Retailers negotiate contracts with DDI providers to sell DDIs for a set price. The contract between the parties sets the price the customer pays for the DDI.
2. The contracts provide that the DDI provider receives a certain percentage or dollar amount of the proceeds from the sale of each DDI. The contracts or other materials clarify that the amount paid by the retailer to the DDI provider is compensation for the service of advertising and selling the DDI on behalf of the retailer, and/or that the DDI provider markets the DDI as an agent or other representative on the retailer's behalf.
3. Customers may purchase DDIs with cash or cash equivalents, and customers may also apply DDI "bucks" or other types of consideration (i.e., reward points, loyalty points, or friend referrals) toward the purchase of the DDI.
4. The terms and conditions of the DDI include specified limitations on the use of the DDI. For example, they may state the DDI cannot be combined with "any other coupons or promotions," or "not valid for" certain items, or the customer "must use in one visit" and/or "no cash back" for partial redemptions of the instrument.

5. An expiration date for the full value (i.e., paid value plus promotional value) of the DDI is printed on the face of the instrument (e.g. six months from the date of issuance). However, the paid value generally has a later expiration date, (e.g., one year from date of issuance of the DDI). As an example, using the above dates, a DDI with a full value of $50 purchased for $25 can be redeemed for its full value ($50) for six months, after which time it can be redeemed for only the paid value ($25) for one year following the date of issuance. After the paid value expires, the DDI has zero value.
6. Retailers do not provide the customer with gift certificates, cash or cash equivalents upon redemption of the DDI.
7. DDIs are a single-use instrument and lose all value after the first use.

Sale of the DDI to the Customer

The purchase of the DDI from a third-party, Internet-based company is not regarded as a sale of tangible personal property (merchandise) or a service. The DDI is merely evidence of an intangible right to receive tangible personal property or a service at a later date and thus does not result in a taxable transaction.

Application of Sales Tax Upon Redemption of the DDI

DDIs that meet the general terms and conditions detailed in this AM section are retailer coupons. The gross receipts subject to tax upon redemption of the retailer coupon (DDI) for tangible personal property includes:

(1) The consideration paid by the customer for the DDI (i.e., the paid value); plus

(2) Any additional cash, credit or other consideration paid to the retailer at the time the retailer rings up the taxable sales transaction.

There is no deduction from the measure of tax when consideration other than cash, such as DDI Bucks, was applied by the customer toward the purchase of the DDI.

In situations where one DDI is offered for taxable and non-taxable sales, the amount paid by the customer for the DDI must be allocated between the taxable and non-taxable charges.

Staff Guidelines

Auditors should be aware that retailers may not properly compute tax on sales of tangible personal property when the customer uses a DDI as all or part of their consideration for the purchase. In many instances retailers apply the DDI as a cash discount, gift certificate, gift card, etc., and do not include the amount the customer paid for the DDI in their taxable gross receipts. The auditor should examine the taxpayer's receipts from third-party, Internet-based companies (e.g., Groupon, LivingSocial) as a method of verification (e.g., date DDIs sold, amount of DDIs sold). Additionally, contracts between the retailer and the DDI provider should be reviewed to determine that the DDI general terms and conditions listed in this AM section are met and to identify the paid value of the DDIs sold by the DDI provider.

Examples of Customer Redeeming DDI:

Example 1:

A website deal-of-the-day offer is $105 toward the purchase of a custom frame at Joe's Framing. The purchase price of the DDI is $50. Customer A purchases the DDI using $40 in cash, plus $10 in the form of "DDI Bucks" previously earned by referring a friend. Customer A then redeems the DDI to purchase a custom frame for $120 (excluding tax). The amount subject to tax is $65, which equals the $50 amount paid for the DDI plus the additional $15 required to be paid by Customer A to purchase the custom picture frame ($120 sales price minus $105 DDI equals $15 additional consideration paid).

Example 2:

Customer B saw the same deal-of-the-day and also purchased the DDI for $50 using cash. However, Customer B redeemed the DDI to purchase a $100 custom frame. The amount subject to tax in this transaction is $50, which equals the amount paid for the DDI. In this transaction, Customer B's purchase did not exceed the full value ($105) of the DDI.

Example 3:

Customer C purchased the same DDI as above for $50, and quickly purchased a frame for $39.99, plus tax, and surrendered the DDI to Joe's Framing for the purchase. Joe's Framing does not refund any cash or store credit to Customer C. Even though the frame cost $39.99, the measure of tax is $50 because that is the total consideration paid by Customer C for the frame.

Example 4:

When two or more retailers enter into a joint venture to offer one single-use DDI for sale:

Best Hotels and Joe's Steakhouse join together to offer a single DDI for the total cost of $50. The DDI includes a hotel stay at a Best Hotel valued at up to $75 plus a meal valued up to $25 at Joe's Steakhouse. The amount paid by the customer ($50) must be allocated relative to the value of the tangible personal property sold and the non-taxable room rental. Since the parties allocated the stated value of the food as 25% of the stated value of the package deal ($25/$100 = 25%), then 25% (i.e., $12.50) of the total amount paid by the customer (i.e., $50) must be allocated to the taxable sale of the meal upon redemption of each single use DDI.

AUDIT MANUAL CHAPTER 9, *GROCERS*

REIMBURSEMENT FOR SALES TAX INCLUDED IN TOTAL SALES 0904.25

The general procedure for verifying a deduction for sales tax included in total sales is outlined in Chapter 4 of the Audit Manual, section 0416.00. However, t~~T~~he following example illustrates the use of the Purchase-Ratio Method ~~"More Accurate Method."~~to compute sales tax included when non-grocery taxable sales are a factor. (For more information on the Purchase-Ratio Method, see Regulation 1602.5(b)(1) and AM section 0906.00).

(a)	Audited taxable grocery purchases	$40,000
(b)	Audited sales tax ~~differential~~ adjustment (7.50~~25~~% of Item a)	~~2,9~~3,000
(c)	Adjusted taxable grocery purchases (Item a + Item b)	4~~2,9~~3,000
(d)	Audited exempt food product purchases	130,000
(e)	Total grocery purchases including sales tax (Item c + Item d)	173,0~~2,9~~00
(f)	Exempt food purchases ratio (Item d ÷ Item e)	75.14~~9~~%
(g)	Total sales including sales tax	254,088
(h)	Nongrocery taxable sales per books, including sales tax (if such sales are not ~~recorded separately~~accurately segregated, markup nongrocery taxable cost of goods sold to compute sales and add 7.50% sales tax to total)	31,500
(i)	Grocery sales including sales tax (Item g – Item h)	222,588
(j)	Exempt food products sales (Item f x i)	167,253~~364~~
(k)	Sales of taxable items including sales tax (Item g – Item j)	86,835~~724~~
(l)	Less taxable items purchased with CalFresh benefits ~~food stamps~~ (2% of the total CalFresh EBT card purchases ~~food stamps redeemed~~ for period, e.g., 2% x $100,000)	2,000
(m)	Taxable sales including sales tax (Item k – Item l)	84,835~~724~~
(n)	Sales tax included (7.50~~25~~/107.50~~25~~ x Item m)	5,~~727~~919
(o)	Measure of tax (Item m – Item n)	78,916~~97~~
(p)	Sales tax payable (7.50~~25~~% x Item o)	5,~~727~~919

NOTE: All amounts and the tax rate are for illustration only. The actual amounts and applicable tax rate must be determined in each particular case.

~~An~~ The following example illustrates ~~of~~ the use of the Purchase-Ratio Method ~~"More Accurate Method"~~ of computing sales tax included when nongrocery taxable sales are not a factor ~~follows~~:

Facts:

Total Grocery Sales including Sales Tax $1,250,000

Purchases:	Food Products	$ 750,000	75%
	Grocery Taxable	250,000	25%
		$1,000,000	100%

Computation:

Exempt Food Products Ratio: ~~750,000~~ ~~= 73.66%~~

$$\frac{750{,}000}{750{,}000 + 250{,}000 + 18{,}\cancel{125}\,750\ (7.50\cancel{25}\% \times 250{,}000)} = 73.62\%$$

Total Sales Including Tax	$1,250,000
Less Food Products (73.62~~6~~% x 1,250,000)	920,2~~7~~50
Taxable Sales Including Tax	329,7~~2~~50
Less Taxable Items Purchased with ~~Food Stamps~~Federal CalFresh benefits (2% x total CalFresh EBT card purchases ~~food stamps redeemed~~ for period, e.g., 2% x $100,000)	2,000
Taxable Sales Including Tax	327,7~~2~~50
Sales Tax Included (7.50~~25~~/107.50~~25~~ x $327,7~~2~~50)	22,~~122~~866
Taxable Sales (ex-tax)	$30~~5,128~~4,884

~~FEDERAL~~ CALFRESH PROGRAM (FORMERLY FOOD STAMPS) 0904.30

The Supplemental Nutrition Assistance Program (SNAP), formerly known as the Food Stamp Program, provides food-purchasing assistance for low-income people living in the U.S. It is a federal aid program, administered by the U.S. Department of Agriculture. CalFresh is California's implementation of SNAP.[1] Under CalFresh, the California Department of Social Services administers and distributes benefits to eligible low-income residents of California. CalFresh public assistance benefits are issued through Electronic Benefits Transfer (EBT) cards. Paper food stamps were replaced by the EBT card. EBT cards are used to purchase eligible food items at authorized retail food stores.

The EBT card is used for two types of public assistance benefits in California, CalFresh benefits and state-authorized cash aid benefits. Thus, at the time of purchase with an EBT card, the recipient must select their CalFresh account to access their CalFresh benefits. See AM section 0419.60 for more information on the EBT card program and the Restaurant Meals Program.

Tangible personal property *eligible* to be purchased with ~~federal food stamps~~CalFresh benefits and so purchased, is exempt from sales and use tax (Regulation 1602.5(c)). This includes sales that would otherwise be taxable, e.g., nonalcoholic carbonated beverages, ice, food coloring extract, etc. Grocers who receive gross receipts from purchases with ~~in the form of federal food stamps~~CalFresh benefits may claim a deduction for ~~redeemed food stamps~~EBT card purchases using CalFresh benefits ~~on~~ of taxable merchandise sold.

Retailers are prohibited from collecting sales tax reimbursement on items purchased with CalFresh benefits ~~food stamps~~ even though such purchases are taxable when purchased with cash. The United States Department of Agriculture, Food~~,~~ and Nutrition Service (FNS) ~~will~~ ensures that retail food stores are not charging sales tax on eligible food items purchased with CalFresh benefits~~food stamps~~. In view of the enforcement procedures by FNS and in the absence of evidence to the contrary, it will be presumed that sales tax reimbursement is not being collected on sales of eligible items paid for with CalFresh benefits~~food stamps~~.

Retailers must be authorized to participate in the CalFresh program and are licensed through the FNS. Each participating retailer is assigned a seven-digit FNS number. Once a retailer is licensed, they must obtain point-of-sale (POS) equipment to process CalFresh purchases via EBT cards. The EBT POS system operates like a debit card system. An electronic message is first sent to a computer for approval. The customer's EBT account then receives an immediate debit and the retailers account is then credited. At the end of the business day, transactions are totaled and the funds are transferred. ~~who accept federal food stamps are required by the FNS to complete a redemption certificate when they deposit food stamps. Each retailer is assigned an authorization number by FNS and must write this number on the redemption certificate. However, the retailer does not keep the redemption certificate. The bank, or other financial institution that cashes food stamps, gives the retailer a receipt for the~~

[1] See http://www.calfresh.ca.gov/

~~deposit and submits the certificate to the FNS. The receipts do not always indicate that the bank deposit includes food stamps. Therefore, not all retailers will have supporting documentation with respect to the total food stamp coupons redeemed.~~

When a retailer receives payment partly in the form of cash and partly from CalFresh benefits~~in the form of food stamps~~, the ~~food stamps~~payments made using CalFresh benefits must be applied first to the gross receipts which would have been subject to tax. The following example is how sales paid with both cash and ~~food stamps~~ CalFresh benefits should be handled:

In this example the customer is paying for their groceries with $15.00 ~~in food stamps~~ from CalFresh benefits and the balance in cash.

a. Taxable Food Items	$20.00
b. Non-taxable Food Items	35.00
c. Taxable Non-food Items (not~~n~~ eligible ~~food stamp items~~to be purchased with CalFresh benefits)	5.00
d. Total Purchases	$60.00
e. ~~Food Stamps~~ Debit to CalFresh account ~~Received~~	15.00
f. Cash Received (includes .75~~3~~ tax)	45.75~~3~~
Total Paid	$60.75~~3~~
Amount of Sale Subject to Sales Tax (a – e + c)	$10.00

If this customer had ~~food stamps~~CalFresh benefits that exceeded the total amount of eligible taxable food items, the remainder should be applied to non-taxable food items only. Tax applies to all sales of taxable items that are not eligible ~~food stamp~~ to be purchased with CalFresh ~~items~~benefits.

Retailers are authorized to report the deduction for ~~food stamps~~purchases made with CalFresh benefits either on an actual basis or by taking a deduction on their sales tax return in the amount of two percent (2%) of the total amount of ~~food stamps~~CalFresh benefit purchases made ~~redeemed~~ in the period for which the return is filed. ~~Effective January 1, 1993,~~ G~~g~~rocers may claim amounts in excess of two percent whenever the following computation results in a greater percentage: total purchases of taxable items eligible to be purchased with ~~food stamps~~CalFresh benefit divided by an amount equal to the total of the exempt food product purchases plus the purchases of taxable items eligible to be purchased with ~~food stamps~~CalFresh benefits. For example, assume the following total purchases for reporting period:

Taxable items eligible to be purchased with ~~food stamps~~ CalFresh benefits	$5,000 [(a)]
Exempt food products	130,000 [(b)]

The allowable percentage to be applied to the retailer's total ~~food stamps~~purchases with CalFresh benefits ~~redeemed~~ is computed as follows:

$$\frac{a}{(a+b)} = \frac{\$5{,}000}{\$135{,}000} = 3.7\%$$

In auditing grocers claiming the deduction based on a percentage of the ~~food stamps redeemed~~ purchases made with CalFresh benefits, the amount recorded as total ~~food stamps redeemed~~ purchases with CalFresh benefits should be accepted if the amount is reasonable for the taxpayer's location and product mix. If the audit is based on a markup of taxable sales, the auditor should give effect to ~~food stamp redemptions~~purchases made with CalFresh benefits of ~~on~~ eligible taxable items. If a ~~food stamp~~ deduction for purchases made with CalFresh benefits is not claimed by the taxpayer, appropriate comments should be made in the audit working papers (e.g., none accepted, etc.).

Retailers who report on the tax accrual method are accounting for ~~their~~ purchases made with ~~food stamp redemptions~~ CalFresh benefits on an actual basis and therefore should not be claiming the exemption based on one of the in lieu methods. The acceptable method for calculating the ~~food stamp redemption~~ deduction for purchases made with CalFresh benefits for taxpayers reporting on the purchase-ratio method or "grocer's formula" is explained in AM s~~S~~ection 0904.25.

TOTAL GROCERY SALES 0906.25

This classification includes sales of all grocery departments operated by the taxpayer including meat, fruit, produce, delicatessen (except hot prepared food or food sold for immediate consumption at facilities operated by the grocer), beverage (except distilled spirits), and bakery departments. Sales tax reimbursement applicable to grocery department sales, amounts received or accrued from manufacturers or others for coupons (excluding handling allowances) redeemed by customers, and the ~~face~~ value of ~~federal food stamps~~purchases made with CalFresh benefits ~~–~~should also be included in grocery sales for purchase-ratio purposes. The following receipts should be excluded for ratio purposes:

(a) Selling price (including tax) of nongrocery taxable items that were eliminated from taxable grocery purchases.

(b) Sales not made in the regular course of business such as sales of equipment.

(c) Sales of meat scraps to rendering plants (see Section 0904.45).

(d) Sales of gasoline, farm seeds, fertilizers, snack bar or restaurant operations.

(e) Deposits (see Section 0904.40).

. . . . . .

(b) **General Outline of Reports, Records and Procedures Used When Reporting With Electronic Scanners** — Grocers will be required to maintain a general outline of their electronic scanner reporting methods. The outline should address the following areas:

1. Type and form of records and reports generated.
2. A description of who is responsible for testing, maintaining and correcting the scanning system. Whether the retailer operates one store or a chain of stores, we need to know who has the authority to enter and/or alter information contained in the "Master List," with respect to price, product, codes, etc.
3. How does the scanner system account for ~~food stamps~~purchases made with CalFresh benefits, manufacturers' coupons, bottle deposits, over rings, etc?
4. If there are department(s) and/or stores handling sales, in whole or in part, in some manner other than with scanners, how are these sales accounted for in the records?

PARTICULAR APPLICATIONS **1208.00**

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PARTIAL EXEMPTION FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT 1208.65

As relevant to construction contracts, Revenue and Taxation Code (RTC) section 6377.1 (see also Regulation 1525.4, *Manufacturing and Research & Development Equipment*) provides a partial sales and use tax exemption for the sale or purchase of (1) qualified tangible personal property; (2) purchased for use by a contractor purchasing that property for use in the performance of a qualified construction contract for a qualified person; (3) who will use the improvement on or to real property or the special purpose building and foundation as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with those processes.

The partial exemption applies to qualifying sales and purchases made on or after July 1, 2014 and before July 1, 2022. The legislation limits the allowable exemption to $200 million in qualifying purchases each calendar year for each qualified person.

When performing qualifying construction contracts for qualified persons, construction contractors should obtain a BOE-230-M, *Partial Exemption Certificate for Manufacturing, Research and Development Equipment*, from the qualified person. If a construction contractor takes a certificate in good faith from a qualified person, and the qualifying person is later found to not qualify for the partial exemption, the qualifying person who issued that certificate will be liable for the payment of tax.

Construction contractors who purchase qualified tangible personal property for use in the performance of a construction contract for a qualified person, who will use that property in a qualifying manner, must issue a partial exemption certificate to the retailer in order for the retailer to claim the partial exemption. The construction contractor may use form BOE-230-MC, *Construction Contracts—Partial Exemption Certificate for Manufacturing, Research and Development Equipment*. If a contractor issues a certificate to its vendor to purchase tangible person property for use in a construction contract for a qualified person subject to the partial exemption, and instead uses those materials for another purpose, the contractor will be liable for the tax.

A construction contractor can also be a "qualified person" if they manufacture tangible personal property provided they meet the criteria in Regulation 1525.4(b)(8)(A). When a construction contractor is a qualified person, the contractor is subject to the $200 million yearly limitation provisions separate from the limitation provisions that apply to the contractor's customers. As a qualified person, the contractor may issue a BOE-230-M partial exemption certificate to their retailer and purchase qualified tangible personal property subject to the partial exemption, provided all other requirements are met.

Equipment used by a construction contractor in the performance of a construction contract for a qualified person does *not* qualify for the partial exemption. *For example*, the lease of a crane used in the construction of a special purpose building does not qualify.

Issuance of a partial exemption certificate certifies in writing that the tangible personal property purchased will be used in a manner entitling the seller to regard the gross receipts from the sale as partially exempt from the sales tax. Purchasers are responsible for tracking their purchases to ensure they do not exceed the $200 million annual cap. If a purchaser exceeds the $200 million limitation, or if within one year from the date of purchase, removes the property from California, converts the property for use in a manner not qualifying for the exemption, or uses that property in a manner not qualifying for the exemption, the purchaser is liable for payment of the sales tax, with applicable interest as if the purchaser was a retailer making a retail sale.

See AM Chapter 4, section 0422.25 for audit procedures.