

M e m o r a n d u m

To : Mr. Ramon J. Hirsig
Executive Director (MIC 73)

Date: August 3, 2004

From : 
Freda Orendt, Acting Deputy Director
Sales and Use Tax Department (MIC 43)

Subject : Proposed revisions to Audit Manual Chapter 9

In accordance with the established procedures for audit and compliance manual revisions, I am submitting the following proposed revisions to Audit Manual Chapter 9, *Grocers*, for your approval to forward to the Board Proceedings Division. These changes have been reviewed and approved by SUTD management, provided to Board Members, and posted on the website for two months at <http://www.boe.ca.gov/sutax/staxmanuals.htm> to solicit comments from interested parties.

Duplicate products were deleted from the taxable items listing in Exhibit 8 based on comments from Board Member staff. On July 22, 2004, we sent a memo advising Board Members of this revision and our intention to place these revisions on the August 24, 2004 Administrative Agenda.

Summary of Revisions

- **AM Section 0901.05.** Refers readers to Exhibit 8 for the listing of “grocery” items to assist in determining if the taxpayer qualifies as a grocery store.
- **AM Section 0904.15.** Corrects the explanation of how tax applies to sales of combination meals of cold food and carbonated or alcoholic beverages sold to go.
- **AM Sections 0911.05, 0912.15.** Revises titles to correspond with the reorganization of the Sales and Use Tax Department.
- **Exhibit 8.** Deletes out-of-date products and adds beer and wine to the list of taxable grocery items.

Attached are copies of these proposed revisions.

We request your approval to forward these proposed changes to the Board Proceedings Division for placement on the next Administrative Agenda as a consent item.

If you have any questions, please let me know or contact Mr. Jeff McGuire at 323-8690.

Approved:



Ramon J. Hirsig
Executive Director

Attachment

cc: (all without attachments)
Ms. Freda Orendt (MIC 47)
Mr. Stephen Rudd (MIC 46)
Mr. Jeff McGuire (MIC 92)

BOARD APPROVED
At the Month Day, Year Board Meeting

Deborah Pellegrini, Chief
Board Proceedings Division

bc: Lynn Whitaker (MIC 44)
AIS Files – AM Revisions

Proposed Audit Manual Revisions

GENERAL

0901.05

For purposes of this chapter, a grocer is a retailer whose principal business is the sale of food products and related items. The term includes separate grocery departments in department stores, but does not include delicatessens, country or general merchandise stores, and establishments that handle groceries as a sideline.

A problem often arises in audits of liquor stores with a substantial volume of sales of merchandise normally sold in grocery stores. Whether these qualify as grocery stores will depend on the fundamental nature of the business. Generally, in order to fall within the definition of a grocery store, at least 50% of the total sales should be comprised of exempt food products and taxable grocery sales. See Exhibit 8 for examples of taxable grocery items to determine if the taxpayer meets the definition of a grocer.

Proposed Audit Manual Revisions

SALES OF FOOD PRODUCTS FOR HUMAN CONSUMPTION

(CONT. 1) 0904.15

Hot Prepared Food

Sales of hot prepared food products are subject to tax regardless of whether sold for consumption on the premises or sold "to go."

A food product is considered a hot prepared food product if it is heated to a temperature above room temperature. Hot food is considered a hot prepared food even if it has cooled by the time of sale since it was intended to be sold as a hot food. Examples of hot prepared food sold by grocers include hot chicken, hot spareribs, hot soups, and hot popcorn. However, tax does not apply to sales of hot bakery items and hot beverages (e.g., coffee, tea, hot chocolate, cider, etc.) if they are sold "to go" and for a separate price.

~~Hot prepared food products also include sales~~ Sales of combination meals (soup and sandwich; or sandwich, chips and drink) for a single price, ~~and such sales are taxable sales even if sold "to go,"~~ if the meal contains any of the following items:

- A hot prepared food (such as a hot sandwich)
- A hot beverage (such as hot coffee or chocolate)
- ~~A carbonated beverage (such as soda or sparkling water)~~
- ~~An alcoholic beverage~~

Proposed Audit Manual Revisions

SALES OF FOOD PRODUCTS FOR HUMAN CONSUMPTION

(CONT. 2) 0904.15

Examples of such types of taxable sales include a combination of a hot pastrami sandwich and salad sold for a single price, and a doughnut and hot coffee sold for a single price.

Food Service Operations

Some grocers may have snack bars, soda fountains, cafeterias or similar operations. Sales of sandwiches, ice cream, or other food product are subject to tax if sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware that grocers provide. For example, if a grocer provides tables and chairs for customer in the store's delicatessen section, tax applies to the food sold for consumption at the tables and chairs. Tax also applies to sales of hot prepared food as discussed above. However, tax does not apply to sales of cold food products sold "to go." If a grocer sells a combination meal that includes a cold food item and a carbonated beverage "to go," only the sale of the carbonated beverage is taxable.

Proposed Audit Manual Revisions

BOARD APPROVAL OF SPECIFIC REPORTING PROCEDURES 0911.00

Approval Guidelines

0911.05

As provided in Regulation 1602.5, grocers who are contemplating use of a *modified purchase-ratio* or *cost plus markup* method of reporting are urged to notify the Board of such intentions and to submit the proposed procedures to the nearest Board office for review prior to use of such procedures. The review, approval, and agreement with the taxpayer on proposed procedures will normally be done at the district or ~~subdistrict~~ branch office level subject to concurrence of the ~~Program Planning~~ Tax Policy Manager. Proposed procedures must be consistent with Regulation 1602.5 and the following guidelines:

- (a) The Board has agreed with the California Grocers Association to review proposed reporting procedures in advance of use, when requested to do so.
- (b) All requests should be honored and sufficient time should be spent to insure that proposed reporting procedures are proper. Time spent in reviewing and approving such requests should be charged to Advisory Services Code 3208, except if verification and instruction are in conjunction with audit verification, in which case, the time should be charged to Direct Field Code 3103.
- (c) A memo to the ~~Program Planning~~ Tax Policy Manager on proposed reporting procedures must spell out in detail the agreement worked out with the taxpayer on procedures to be followed and the recommended period of authorization. A copy of this memo must be sent to the Chief of Field Operations, or the Collections and Third District Operations Manager.
- (d) Authorizations for use of approved procedures generally should be issued to coincide with the ending period of the next audit plus one quarter. However, letters of authorization should not be issued for periods of less than two years. Therefore, if the next anticipated audit period ends in a period less than eighteen months from the date of the request, the authorization should be granted for three years plus the period to the end of the next scheduled audit plus one quarter. For example, if the last audit was through December 1996, and a request is received in July 1999, the authorization should be for the period ending March 31, 2003. On the other hand, if the last audit was through December 1997, the authorization should be through March 31, 2001.

The approval should be granted subject to the understanding that the procedures will be reexamined at the time of the next regularly scheduled audit, and the taxpayer will be required to make current tests as deemed necessary in order to obtain a new letter of authorization.

- (e) Written authorization of approved procedures will be furnished to the taxpayer by the ~~Program Planning~~ Tax Policy Manager only. Districts will not furnish written approval. This is to insure uniformity of practice and maintenance of a central record of all authorizations. It is therefore essential that districts furnish the ~~Program Planning~~ Tax Policy Manager with complete information on proposed reporting procedures.
- (f) Letters of authorization will not normally be furnished for reporting procedures other than modified purchase-ratio or cost plus markup, as specifically provided for in Regulation 1602.5.

Proposed Audit Manual Revisions

Board Review of Specific Procedure

0912.15

Grocers contemplating use of scanning system results for sales tax reporting purposes are *required* to notify the Board of such intentions and to submit a general outline of the proposed reporting method to the Board for review and approval prior to adoption of such method for reporting purposes. All requests from grocers to report using electronic scanner systems, will be referred to the appropriate district office for review. Once district staff has reviewed the grocer's reporting procedures to determine if they are in substantial compliance with the guidelines set forth in Section 0912.20, the District Administrator will submit a memo to the Program Planning Tax Policy Manager, stating his/her recommendation with regard to the taxpayer's request. A copy of this memo must be sent to the Chief of Field Operations, or the Collections and Third District Operations Manager.

The Program Planning Tax Policy Manager may:

- 1) Concur with the district recommendation, in which case, a reply will be sent to the taxpayer (with a copy to the district) indicating that the request was approved, subject to the agreed guidelines, or disapproved, and stating the reasons the request has not been approved.
- 2) Disagree with the district recommendation, in which case, a reply memo will be sent to the District Administrator indicating the nature of the disagreement and providing further instructions on how the district should proceed to assure a timely resolution of the grocer's request.

Proposed Audit Manual Revisions

CLASSIFICATION OF PRODUCTS SOLD BY GROCERS

EXHIBIT 8

A. TAXABLE GROCERY ITEMS

Examples of "taxable grocery items" regularly sold in grocery stores include the following:

Aluminum Foil	Ice
Ammonia	Insect Spray, Poison, Bombs
Ant Poison	Kleenex
Antacid Mints	Kotex, Tampax, Coets, Fems
Asphalt Tile Cleaner	Laundry Soap
Bags - Lunch	Light Bulbs and Fuses
<u>Beer</u>	Lighter Fluid
Bird Seed	Lozenges (medicated)
Bird Treats (food)	Lye
Bleach - Laundry	Matches
Bottle Brushes	Mops, Mop Handles
Brooms	Moth Protection - All Kinds
Candles	Muffin Papers
Canning Jars and Lids	Paper Cups, Plates, Napkins
Carbonated Beverages (sodas)	Paper Towels
Cat Food	Parawax
Charcoal Briquettes	<u>Plastic Eating Utensils</u>
Cigarette Fluid, Wicks, Flints	Plastic Film/Wrap
Cigarettes	Powder (cleaning)
Cigars	Rolaids
Cleaners and Polishes (household)	Rust Stain Remover
Clothes Cleaning Fluid	Salt - Ice Cream
Clothes Pins	Sandwich Bags
Coloring Extracts	Scouring Pads
Cough Drops	Silver Polish
Deodorizers (air fresheners)	Soap and Detergent
Dietary Supplements or Adjuncts	Sponges
Dishcloths	Starch - Laundry
Dog Food	Straws
Drain Cleaners	Table Covers - Paper
Dye - Clothes	Tile Cleaner
Facial Tissues	Toilet Tissue
Floor Wax and Applicators	Toothpicks
Fly Swatters	Upholstery Cleaner
Freezer Tape	Water Softener (laundry)
Fuel - Cooking, Heating	Water Softener Salt
Furniture Polish	Wax Paper
Garbage Bags	Wax Remover
Glass Cleaner, Glass Wax	Whisk Brooms
	<u>Wine</u>
	Wood and Plastic Utensils

Proposed Audit Manual Revisions

CLASSIFICATION OF PRODUCTS SOLD BY GROCERS

(CONT.) EXHIBIT 8

B. NONGROCERY TAXABLE ITEMS

Examples of taxable items not regularly sold in grocery stores referred to as “nongrocery taxable items” include the following:

Accessories – Auto	Gloves
Adhesive Tape	Hair Dye
Ammunition	Hair Oil
Antacid Liquids	<u>Styling Products</u>
Appliances – Household, Auto	Hardware
Auto Cleaner, Polish, Waxes	Medicated Cleansers
Baby Oil	Medicine for Pets
Batteries – Auto, Flash Light	Notebooks
Books	Nursery Stock
Bubble Bath	Pencils, Pens & Ink
Cameras	<u>Pet Litter</u>
Chinaware	Pet Supplies & Equipment (not food)
Cigarette Lighters	Pots & Pans
Clothing	Powder (face or body)
Cosmetics	Rawhide Chew Bones
Deodorizers (body)	Razors
Diapers (cloth or disposable)	Razor Blades
Dishes	Rubber Bands
Distilled Spirits	Sand & Grit for Pets
Drug Sundries	School Supplies
Electrical Supplies	Scotch Tape
Farm & Garden Implements	Seed (except vegetable)
Fertilizers	Shaving Cream & Lotion
Film	Shampoo & Rinse
Firearms	Shoe Laces & Polish
Flambé, Flambeau, Flambeaux	Silverware
Flashlights	Sporting Goods
Flower & Garden Seeds	Stationary
Flowers	Sun Glasses
Fuel & Lubricants (includes diesel fuel, grease, etc.)	<u>Sun Tan Lotion and Sunscreen</u>
Furniture	Thread
Garden Tools & Supplies	Three in one Oil
Glassware	Tools
	Toothpaste
	Toys