

Tax Information Bulletin

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California State Board of Equalization
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New laws take effect



The legislative changes described below take effect January 1, 2003, unless otherwise indicated. You can download copies of referenced bills from www.leginfo.ca.gov/bilinfo.html. Or you can mail your request to: Legislative Bill Room, State Capitol, Room B-32, Sacramento, CA 95814.

Waiver of interest and penalty charges for certain delinquent taxpayers

Assembly Bill 2065 (Stats. 2002, ch. 488), effective September 12, 2002, authorizes the Board, for the period beginning October 1, 2002, and ending June 30, 2003, to identify eligible taxpayers with high-risk collection accounts and to notify them they may satisfy an unpaid tax liability by paying the tax in full and receiving a waiver of interest and penalties. This provision applies to any final sales or use tax liability including tax, penalties, and interest, that is owed by a taxpayer and is unpaid as of October 1, 2002.

Retail sales of cigarettes

Senate Bill 1766 (Stats. 2002, ch. 686) provides that all retail sales of cigarettes to customers in the state must be vendor-assisted, face-to-face sales unless the seller meets certain speci-

fied conditions. A seller may engage in a non-face-to-face sale of cigarettes to a person in California provided the seller pays to the Board all taxes due on the sale or includes a prominent note on the package indicating that the purchaser is responsible for all California tax due on the cigarettes. Does not apply to vending machine sales

Tribal taxes imposed by Indian tribes within California

Assembly Bill 2701 (Stats. 2002, ch. 593) excludes from the measure of sales or use tax any tribal taxes imposed by an Indian tribe within California with respect to a taxable sale of merchandise. This exclusion only applies to Indian retailers that are in substantial compliance with

the Sales and Use Tax Law and when the tribal tax is based on a percentage of the sales or purchase price of the merchandise.

Bunker fuel exemption to end

Senate Bill 145, which would have extended the sunset date for the bunker fuel exemption, was vetoed. Therefore, this exemption will expire on January 1, 2003.

Diesel fuel purchases

Senate Bill 1901 (Stats. 2002, ch. 446), operative October 9, 2002, provides that qualified fuel retailers may issue an exemption certificate to a diesel fuel seller to exempt their purchases of diesel fuel from the prepayment requirements when the fuel is sold to

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Several regulations affecting the graphic arts industry have been revised

The following sales and use tax regulations have been revised:

- 1540, Advertising Agencies, Commercial Artists and Designers
- 1541, Printing and Related Arts
- 1543, Publishing
- 1528, Photographers, Photocopiers, Photo Finishers and X-Ray Laboratories

We have prepared a supplemental article that describes these changes in detail. You can download a copy from www.boe.ca.gov/news/tib02.htm. Or you can request a fax copy from our Information Center at 800-400-7115 (choose automated services). Copies of sales and use tax regulations can also be obtained from our Information Center, or you can go online to www.boe.ca.gov/sutax/staxregs.htm.

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Sidelights

■ New District boundaries take effect

With California's entry into the 21st Century, the four Board of Equalization Districts have changed to match the shifting state population. Based on state legislative redistricting efforts—and using the 2000 Federal Census, each reconfigured district will represent approximately 8.5 million people.

The Board Member elections held last month were based on the new boundaries. However, for the remainder of 2002, the incumbent Board Members will continue to serve the districts as configured when they were last elected.

If you would like to view the new district maps, please go online to www.assembly.ca.gov/committee/c7/2001pdfs/newtextdocument.html (scroll to the bottom of the page to locate the Board maps).



■ Annual filers—don't miss out! You can receive all four bulletins each year.

If you file tax returns only once a year, you do not receive each quarterly *Tax Information Bulletin*. As a result, you may miss some important news such as upcoming law changes, regulation revisions, e-filing, and more.

If you would like to receive each quarterly issue, you may ask to be added to Mailing List #15 by (1) writing to Addressing Systems, MIC: 12; Board of Equalization; PO Box 942879; Sacramento, CA 94279-0012; or (2) sending us an e-mail at www.boe.ca.gov/info/email.html.

Tax Information Bulletins are also available online at www.boe.ca.gov/news/tibcont.htm, or you can request copies from our Information Center.

Sales of Ensure and other dietary supplement products are taxable

Generally, sales of food for human consumption are exempt from tax.

However, sales tax does apply to sales of products that are

- In liquid, powdered, granular, tablet capsule, lozenge, or pill form, and
- Sold as dietary supplements or adjuncts or sold for weight loss.

Sales of such products are taxable if the item is

- Described on its label or package as a food supplement, food adjunct, dietary supplement or dietary adjunct, or
- Prescribed or designed to remedy specific dietary deficiencies or to increase or decrease generally those areas of human nutrition dealing with vitamins, proteins, minerals or calories.

The sale of an item in the specified forms may also be taxable if it is generally recognized as a dietary supplement, even though it is not described on its package as such and does not emphasize its vitamin, protein, mineral or calorie content. Examples include cod liver oil, wheat germ oil, and amino acid products.

When an item is classified by the Board as a food or nonfood product because of its labeling or packaging, the tax status of that item may change if the labeling or packaging changes.

Ensure products

The Board previously classified Ensure and Ensure Plus as exempt food because their labels did not describe the products as supplements. However, we have examined the current labels for Ensure and Ensure Plus, and the products are now labeled as "nutritional supplements." They also indicate a doctor should be consulted if the user intends to use the products as their sole source of nutrition. Because the labeling of these products has changed, the application of tax has also changed. Grocery stores and other retailers that sell Ensure and Ensure Plus should report tax on their sales of those products.

Note: You will need to reprogram your cash registers if they designate these Ensure products as nontaxable food items.

California retailers who drop ship merchandise on behalf of out-of-state retailers may owe tax

If you make drop shipments or courtesy deliveries to consumers in California on behalf of out-of-state retailers, you are not liable for sales and use tax if the out-of-state retailer holds or is required to hold a California seller's permit or a Certificate of Registration-Use Tax. An out-of-state retailer who is required to hold either permit is considered the retailer and is liable for tax.

However, you are considered the retailer and are generally liable for tax if

- The out-of-state retailer is not required to hold a California seller's permit or Certificate of Registration-Use Tax, and
- The retail sale of the property is subject to California sales or use tax.

Prior to January 1, 2001, drop shippers were required to report tax based on the final selling price to the California consumer. For reporting periods on and after January 1, 2001, drop shippers may calculate the selling price of drop-shipped merchandise using the methods described in Regulation 1706, *Drop Shipments*. This regulation includes a provision that for sales and use tax reporting purposes, a drop shipper may calculate the retail selling price of its drop shipped property based on its selling price of the property to its direct customer, the out-of-state retailer, plus a markup of 10 percent.

Example 1: DropShipper, Inc. holds a California seller's permit. DropShipper, Inc.'s customer, Outside Supply, is located outside California and does not hold a permit to collect California sales and use tax. Outside Supply purchases office equipment for resale from DropShipper, Inc. for \$7,500 and directs DropShipper, Inc. to ship it directly to Outside Supply's customer in California. The California customer will use the equipment at its California location. DropShipper, Inc. is responsible for tax measured by the retail selling price of the equipment paid by the California consumer to Outside Supply. On or after January 1, 2001, DropShipper, Inc. may calculate the measure of its tax liability based on its selling price to Outside Supply plus a markup of 10 percent (10%). In this example, DropShipper, Inc. would be liable for tax on \$8,250 (\$7,500 + \$750).

If the California customer is purchasing the property for resale, drop shippers are not liable for tax if they obtain a valid resale certificate from the California customer.

Example 2: Same as Example 1 except Outside Supply's California customer is a retailer of the office equipment. DropShipper, Inc. would not be liable for tax on the transaction if it obtained a valid resale certificate from the California customer. Note that a resale certificate from Outside Supply (DropShipper, Inc.'s direct customer) is not sufficient to relieve DropShipper, Inc. from tax.

Drop shipment transactions can be complicated and involve many parties. If you have questions about how tax applies to your drop shipment transactions, order Regulation 1706 or call our Information Center.

You may owe use tax on sample merchandise given to potential customers

Sellers often give away product samples to allow potential customers to use and analyze the product before they make a purchase. If those samples are withdrawn from inventory in which the products, or the materials used to make them, were purchased for resale without tax, the seller must report tax on the purchase price of the samples given away.

Sellers are not required to report tax on property they loan to potential customers if the loaned property is being used for demonstration or display purposes while being held for sale in the regular course of business.

Please note:

- Tax applies even if the product is delivered to an out-of-state recipient.
- If you manufacture the product that is given away, only the purchase price of the materials used to make the product is subject to tax.



Example 1: You manufacture a new gardening tool in California. To convince home improvement stores to carry your product, you give away product samples to store managers so they can try the tool themselves. The tools are shipped by common carrier to recipients throughout the country. Suggested retail price of the tool is \$10.00. Material cost (from resale inventory) to make the product is \$2.00, labor cost is \$4.00.

You owe use tax on \$2.00 for every tool given away. Note that only the cost of the materials used to make the tool is subject to tax – not the labor cost.

Use tax is due regardless of where the product is shipped. Use occurs in California because the gift of the tool is made when it is delivered to the shipper in California.

(SAMPLES continued on page 4)

Sidelights

■ Know your rights

As a taxpayer, you have many rights under the Sales and Use Tax Law. These include the right to know how the law affects you; be treated fairly, courteously, and promptly, and question the actions and decisions of Board staff and officers that affect your business operations.

Of course, along with those rights, you have certain responsibilities, including the responsibility to keep informed about tax laws and regulations; report and pay taxes when due; and maintain adequate records of your business operations.

For more information on your rights, please order publication 70, *The California Taxpayers' Bill of Rights*. Call our Information Center or go online for a copy.

■ Civil behavior in trying times

Some observers have noted that civility is decreasing in our society as our lives become more complex. We know that you may find yourself frustrated with the difficulties of the tax law or pressed for time when you're dealing with our staff. Still, we ask that you treat our employees just as you would like to be treated in a business situation. Any statement made to a Board employee that seems remotely like a threat—even a statement made in jest—will be referred to our Internal Security and Audit Division for investigation.

■ Ethics at work— "thank you" is enough

During the holiday season, many of you offer gifts to your customers, suppliers, and others with whom you do business. We must ask, however, that you not extend your generosity to our employees. A simple "Thank You" or "Happy Holidays" will have to do—and will be much appreciated, we're sure! Board policy prevents our employees from accepting gifts of any type.

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Example 2: You sell vacuum cleaners. You allow a potential customer to use the vacuum cleaner in his home for 5 days at no cost to the customer. If he likes the product, he will purchase the item from you at the retail price. If the customer does not want to purchase the vacuum, he must return the product to you. You will return it to your resale inventory.

If the customer buys the vacuum cleaner, the retail sale is subject to tax. If the customer does not buy the vacuum cleaner, you do not owe sales or use tax. Although the product is temporarily away from your store, it remains property for demonstration purposes while being held for sale during the regular course of business. This does not constitute a taxable use.



If you owe use tax on samples given away, you should report that liability on line 2 of your tax return, "Purchases Subject to Use Tax." The use tax rate is the same as the sales tax rate. For more information, order or download publication 110, *California Use Tax Basics*, or Regulation 1670, *Gifts, Marketing Aids, Premiums and Prizes*.

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persons who qualify for the exemption under section 6357.1 of the Sales and Use Tax Law. This section exempts from the five percent state sales and use tax sales and purchases of diesel fuel used in farming activities and food processing.

The exemption certificate must indicate the volume of diesel fuel that the fuel retailer reasonably expects he or she will sell that qualifies for the exemption under section 6357.1.

Sales to nonprofit organizations are usually taxable

Many organizations that are granted nonprofit status by the IRS or the California Franchise Tax Board mistakenly believe that sales to their organizations are automatically exempt from California sales tax. There is no general exemption from California sales and use tax for sales to nonprofit, charitable or religious organizations. Accepting an exemption certificate from a nonprofit group with their federal or state income tax exemption number does not necessarily relieve you from reporting sales or use tax on the transaction.

As a rule, tax applies to purchases by nonprofit organizations of items they will use, such as office equipment and supplies. California law does provide specific exemptions from sales and use tax for transactions by some nonprofit organizations. If you have a question concerning a tax exemption for a nonprofit organization, please see publication 18, *Tax Tips for Nonprofit Organizations* or call our Information Center.

New or revised reference material

Sales and Use Tax Publications

- 26 Tax Information Bulletin Index (August 2002)
- 32 Tax Tips for Purchasers from Mexico (September 2002)
- 42 Resale Certificate Tips (July 2002)
- 73 Your California Seller's Permit (July 2002)
- 79-B California Individual Use Tax (July 2002)
- 102 Sales to the U.S. Government (September 2002)
- 103 Sales for Resale (June 2002)
- 108 When is Labor Taxable? (August 2002)

Sales and Use Tax Regulations

- 1507 Technology Transfer Agreements (effective July 6, 2002)
- 1525.7 Rural Investment Tax Exemption (effective July 7, 2002)
- 1533 Liquefied Petroleum Gas (effective August 1, 2002)
- 1533.1 Farm Equipment & Machinery (effective July 7, 2002)
- 1533.2 Diesel Fuel Used in Farming Activities or Food Processing (effective August 1, 2002)

Translated Publications

- 33-HG Making Sales in California (Hmong) • February 2001
- 33-JE Making Sales in California (Japanese) • February 2001
- 42-S Resale Certificate Tips (Spanish) • July 2002
- 73-F Your California Seller's Permit (Farsi) • April 2001
- 73-K Your California Seller's Permit (Korean) • April 2001
- 73-S Your California Seller's Permit (Spanish) • April 2001
- 74-C Closing Out Your Seller's Permit (Chinese) • December 2001
- 74-S Closing Out Your Seller's Permit (Spanish) • December 2001
- 100-S Shipping and Delivery Charges (Spanish) • November 2000
- 102-S Sales to the U.S. Government (Spanish) • September 2002
- 112-S Purchases from Out-of-State Vendors (Spanish) • April 2002

For More Information All telephone numbers are toll-free.

Information Center	800-400-7115 Telephone devices for the deaf 800-735-2929 (TDD) ■ 800-735-2922 (Voice)
Internet	www.boe.ca.gov ■ www.taxes.ca.gov
Requests for Fax Copies	800-400-7115 (Choose automated services.)
Seller's Permit Verification	888-225-5263 ■ www.boe.ca.gov
Taxpayers' Rights Advocate	888-324-2798 ■ www.boe.ca.gov
Tax Evasion Hotline	888-334-3300
State Legislation	www.leginfo.ca.gov