

Tax Information Bulletin

STATE BOARD OF EQUALIZATION

ISSUED QUARTERLY
March 1999

BOARD MEMBERS

JOHAN KLEHS
First District
Hayward

DEAN F. ANDAL
Second District
Stockton

CLAUDE PARRISH
Third District
Torrance

JOHN CHIANG
Fourth District
Los Angeles

KATHLEEN CONNELL
State Controller
Sacramento

EXECUTIVE DIRECTOR
E. L. SORENSEN, JR.

◆ In This Issue

New Tax Districts and New Rates

The tax rates in Fresno County and the City of Placerville (in El Dorado County) will increase on April 1, 1999. See articles 1 and 2.

Speakers Available

Having a business meeting? Consider inviting a Board representative to speak to your group. See article 3.

Get Tax Advice in Writing

Tax relief may apply if you receive erroneous written advice from the Board. See article 4.

Internet Sales

Did you know that your sales of downloaded products may not be subject to tax? Are you an out-of-state retailer? Read article 5 for more information.

Two-for-One Sales

Many retailers mistakenly charge tax on the free item. See article 6.

Tax Returns and Filing Information

Understanding the deduction, "Tax-Paid Purchases Resold." See article 7.

Sales tax prepayments: Do you know the special due dates for the second quarter? See article 8.

Distributions of Fuel

The sales tax prepayment rate on fuel distributions will decrease on April 1, 1999. See article 9.

Cigarettes and Tobacco Products

See articles 10 and 11 for information on new tax rates and sales of "export product" cigarettes.

Underground Storage Tanks

Do you own an underground storage tank and store petroleum products in it? If so, be sure to read article 12.

Imported Beer

If you are an out-of-state beer manufacturer, you may be liable for tax on beer stored in California. See article 13.

New or Revised Reference Material

See article 14.

Read Your Inserts—

Read about changes to federal credit card purchases. The card numbers give you important information.

1. Sales and Use Tax Rate To Increase in Fresno County

On April 1, 1999, the sales and use tax rate in Fresno County will increase from 7.75 percent to **7.875** percent. This rate increase reflects the addition of a 0.125 percent rate for the new voter-approved Fresno County Public Library Transactions and Use Tax (FCPL).

Who must apply the new tax rate?

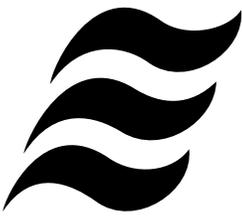
You must apply the new 7.875 percent tax rate if you

- Are a retailer in Fresno County and your merchandise is sold and delivered within the county.
- Are a dealer of vehicles, vessels, or aircraft and you sell those items to persons who will register or license them to an address in Fresno County.
- Are a retailer located outside Fresno County who is *engaged in business* in the county and you sell merchandise for use in the county. You are considered to be engaged in business in the county if you (1) have any type of business location there, (2) deliver into the county using your own vehicles, or (3) have an agent or representative in the county who makes sales, takes orders, or makes deliveries for you.
- Collect tax on lease payments you receive for leased property used by the lessee in Fresno County.

The new rate applies to all taxable charges except for certain fixed-price contracts and leases, as discussed below.

Is there an exemption from the tax rate increase?

In general, fixed-price contracts and fixed-price lease agreements entered into prior to April 1, 1999, are subject to the rates in effect at the time you and your customer entered into the contract. To qualify as "fixed-price," neither party can have the



unconditional right to adjust the price for an increase in costs or terminate the contract or lease [Revenue and Taxation Code, sections 7261(g) or 7262 (f)]. In addition, the tax amount or rate must be specifically stated in the contract or lease agreement. If the contract or lease qualifies as fixed-price, you should continue to report and remit the specified tax rate — that is, the rate in effect at the time you entered into the contract.

If you and your customer entered into a fixed-price contract or fixed-price taxable lease agreement prior to April 1, 1999, the tax rate that should generally be reported and remitted for Fresno County is 7.75 percent, which is the rate in effect from July 15, 1991, through March 31, 1999. If you and your customer entered into a fixed-price contract or fixed-price taxable lease agreement prior to July 15, 1991, the tax rate will differ.

2. Sales and Use Tax Rate To Increase in the City of Placerville

On April 1, 1999, the sales and use tax rate within the city limits of Placerville will increase from 7.25 percent to **7.50** percent. This increase reflects the statewide 7.25 percent rate **plus** 0.25 percent for the new voter-approved City of Placerville Public Safety Transactions and Use Tax (PLPS).

Note: Placerville is located in El Dorado County. The tax rate in areas of the county outside the city limits of Placerville will remain at 7.25 percent.

Who must apply the new tax rate?

You must apply the new 7.50 percent tax rate if you

- Are a retailer in Placerville and your merchandise is sold and delivered within the city.
- Are a retailer located outside of Placerville who is *engaged in business* in the city and you sell merchandise for use in the city. You are considered to be engaged

in business in the city if you (1) have any type of business location there, (2) deliver into the city using your own vehicles, or (3) have an agent or representative in the city who makes sales, takes orders, or makes deliveries for you.

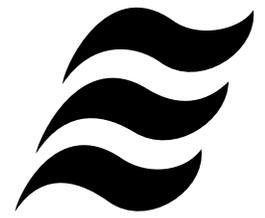
- Are a dealer of vehicles, vessels, or aircraft and sell those items to persons who will register or license them to an address located in Placerville.
- Collect tax on lease payments you receive for leased property used by the lessee in Placerville.

The new rate applies to all taxable charges except for certain fixed-price contracts and leases, as discussed below.

Is there an exemption from the tax rate increase?

In general, fixed-price contracts and fixed-price lease agreements entered into prior to April 1, 1999, are subject to the rates in effect at the time you and your customer entered into the contract. To qualify as “fixed-price,” neither party can have the unconditional right to adjust the price for an increase in costs or terminate the contract or lease [Revenue and Taxation Code, sections 7261(g) or 7262 (f)]. In addition, the tax amount or rate must be specifically stated in the contract or lease agreement. If the contract or lease qualifies as fixed-price, you should continue to report and remit the specified tax rate — that is, the rate in effect at the time you entered into the contract.

If you and your customer entered into a fixed-price contract or fixed-price taxable lease agreement prior to April 1, 1999, the tax rate that should generally be reported and remitted for Placerville is 7.25 percent, which is the rate in effect from July 15, 1991 to March 31, 1999. If you and your customer entered into a fixed-price contract or fixed-price taxable lease agreement prior to July 15, 1991, the tax rate will differ.



3. Speakers Available for Your Industry Meetings

If you are having a business meeting, luncheon, or convention for representatives of a specific industry, you can request a speaker from the Board of Equalization to provide information regarding how sales or use tax applies to that industry.

To request a speaker, send your written request to your local Board of Equalization office, to the attention of the District Administrator. Your request should include information about the industry, a brief commentary of the main topics you would like covered, when and where the meeting is to take place, and the name and telephone number of the contact person.

4. It Is Best To Get Tax Advice in Writing

Each year, we receive many calls from businesses needing help with their tax questions. While we are always glad to provide help and guidance over the telephone, we would like to remind readers that it is always best to get tax advice in writing.

You may be relieved of tax, penalty, or interest charges if the Board determines you reasonably relied on written advice from us and in reliance upon that advice did not charge or collect sales tax reimbursement or use tax from your customer or pay use tax on your storage or use of property you purchased. Such relief is not available for advice given over the telephone or in person.

This relief is available if the advice provided by Board staff was in response to a written request from you, in which you fully described the specific facts and circumstances of the activities or transaction for which you were requesting advice. In describing the specific facts of a transaction, it would be helpful if you included in your letter copies of representative documents for your business

transactions, such as sales contracts, purchase orders, and invoices.

5. Internet Sales—An Update

In the December 1998 Bulletin, we published a general article on Internet sales. The following update (1) discusses whether tax applies to sales of electronic data products and (2) clarifies whether businesses that use television or other broadcast systems to solicit sales are engaged in business in California.—Editor

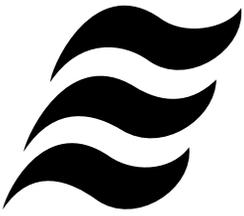
Sales of electronic data products

While there is no specific tax exemption for sales made over the Internet, some of your Internet sales may not be subject to tax. For example, the sale of electronic data products is generally not taxable when the products are electronically transferred to your customers, whether over the Internet, by modem, or by other electronic means. However, if as part of the sale you provide your customer in California with tangible personal property—such as a hard copy of the electronically transferred information or a copy on a physical storage medium such as a CD-ROM or diskette — your sale of the electronic product may be taxable.

For example, if your software company sells programs to customers who download them from a server, those sales are generally not subject to tax. However, if you also provide your customers with a backup copy on a portable storage medium, the entire transaction is subject to tax unless the software qualifies as a custom program. Similarly, if you transmit a stock (noncustomized) database to your customer over the Internet and also mail your customer in California a printed copy of the contents, the entire sale is subject to tax.

Out-of-state businesses that solicit sales from customers in California by means of television or other broadcast media

In December we listed criteria used to determine whether an out-of-state retailer is



“engaged in business” in California and required to register and report tax. One criterion was that the retailer “solicit orders for merchandise over a telecommunication or television shopping system that broadcasts in California by cable television or any other broadcast method and that uses toll-free numbers to accept orders.” It should be noted that under this criterion, the out-of-state retailer is considered to be engaged in business in this state *if the toll-free operator is physically located in California*. If the operator is located outside California, the criterion does not apply.

Reminder: You may still be engaged in business in California if any of the other provisions listed in the December article apply to your business operations.

6. Common Errors Discovered in Audits: Application of Tax to Two-For-One Sales

As a restaurant, bar, or other retail outlet operator, you may offer your customers two-for-one sales. Generally, a two-for-one sale occurs when your customer pays regular price for one item in order to receive a second item at no additional cost.

If you furnish your customer a free meal or other item when a like item is purchased, sales tax does not apply to the value of the free meal or item. Sales tax should only be computed on the amount received for the sale. The free item is considered a discount. Unless you are reimbursed for the cost of the free item, the discount is not taxable.

If you include the nontaxable value of the free item in the subtotal, you must subtract it before you calculate the sales tax. Otherwise, you will collect too much sales tax reimbursement from your customer. Any excess tax reimbursement must be either refunded to your customer or paid to the Board of Equalization.

7. Don't Overpay Tax: When To Claim a Deduction for “Tax-Paid Purchases Resold”

If you are a retailer and pay sales tax reimbursement or use tax on your purchase of merchandise that you later resell, you may be entitled to take a deduction on your tax return for the cost of the resold merchandise (the amount you paid for the merchandise).

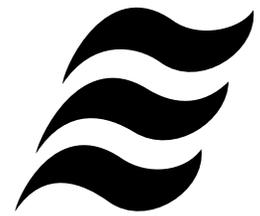
By taking a deduction on your return, you will lower your tax liability for the reporting period and, as a result, be credited for the tax previously paid on your purchase. This deduction is listed on your tax return as “cost of tax-paid purchases resold prior to use.”

Circumstances under which you can claim this deduction include the following:

- You made a purchase with the intent to use the property, but later resold it before making any use of it (other than retention, demonstration or display).
- You do not ordinarily sell or stock the particular property and consequently did not purchase it with a resale certificate. Your sale of the property is unusual — for example, it is made to accommodate an employee or a customer.
- You did not use a resale certificate to purchase the property because you generally use it. However, you may occasionally sell a small amount prior to use.
- You mistakenly paid sales tax reimbursement or use tax on property you purchased for resale in the regular course of business.

You should take the deduction on the return filed for the period in which the property was resold. If you do not take the deduction in the proper period, you must file a claim for refund to recover the tax overpayment.

As a general rule, in order for you to take this deduction, tax must be due on the sub-



sequent retail sale of that specific property. You can also take this deduction for an exempt sale of the merchandise (for example, a sale in interstate or foreign commerce); however, you must have other transactions reported on your return that are taxable and against which the credit can be applied. Otherwise, you must file a claim for refund.

Please call our Information Center if you have questions regarding this deduction. You may also request a copy of Regulation 1701, *Tax-Paid Purchases Resold*.

8. Special Due Dates for Second Quarter Sales Tax Prepayments

Businesses with average taxable sales of \$17,000 per month or more are required to make prepayments. They must continue to make prepayments until advised in writing by the Board to stop. – Editor

If you make sales and use tax prepayments (by paper or through electronic funds transfers), you should mark your calendar to remind yourself of the upcoming second quarter prepayment due dates. Every year at this time special quarterly sales tax prepayment and EFT prepayment requirements take effect for the second calendar quarter (April through June), and every year a number of taxpayers who make prepayments are taken by surprise.

First Prepayment

Your first prepayment is due on or before May 24, 1999. You must pay one of the following amounts:

- 95 percent of the tax liability due for the month of April 1999; or,
- One third of the measure of tax liability reported for the same quarterly period of the preceding year (2nd Quarter 1998), multiplied by the current tax rate. To use this second method of calculating the prepayment, you or your predecessor (the previous owner) must have been in business during all of the second quarter of 1998.

Second Prepayment

The second prepayment is due on or before June 23, 1999. You must pay one of the following amounts:

- 95 percent of the tax liability due for the period from May 1, 1999, through June 15, 1999, or
- 142.5 percent of the tax liability due for the month of May 1999, or
- An amount equal to one-half the measure of the tax liability reported for the same quarterly period of the preceding year (second quarter 1998), multiplied by the tax rate in effect when the payment is made. Again, to use this method, you or your predecessor must have been in business during all of the second quarter of 1998.

If you pay prepayments by check, money order, or in cash, all the appropriate forms for making the prepayment will be sent to you about a month before the due dates. If you pay by EFT, you will not receive any prepayment forms; therefore, please write the due dates on your calendar.

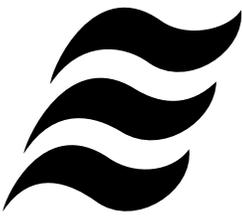
The penalty for late prepayments, including those made by EFT, is six percent of the amount of the prepayment.

9. Decrease in Sales Tax Prepayment Rates for Distributions of Qualifying Fuels

Beginning April 1, 1999, the following prepayment rates will apply to distributions of gasoline, diesel, and other qualifying fuels:

- 7.0 cents (\$0.070) per gallon for motor vehicle fuel (gasoline)
- 5.5 cents (\$0.055) per gallon for diesel, aircraft jet fuel, and other qualifying fuels, as described below

Other qualifying fuels include kerosene, any type of flammable liquid sold as or marketed as diesel fuel, and home heating oil meeting industry specifications for diesel No. 1 or No. 2.



What fuels are excluded from sales tax prepayments?

Sales tax prepayments do not apply to liquefied petroleum gas, compressed natural gas, liquid natural gas, and methanol and ethanol containing not more than 15 percent gasoline or diesel fuel. In addition, prepayments do not apply to any type of fuel that cannot be used to operate a motor vehicle on public highways, such as marine bunker fuel, atmospheric gas oil, light cycle oil and pipeline transmix.

How long will the new rates remain in effect?

These rates will remain in effect through March 31, 2000, unless the price of gasoline increases or decreases significantly, resulting in prepayments that consistently exceed or are significantly lower than the fuel retailer's sales tax liability.

10. New Tax Rates for Cigarette and Tobacco Products

With the passage of Proposition 10 in November 1998, the following tax rate changes took effect January 1, 1999.—Editor

Cigarettes

The excise taxes on cigarettes increased from 37 cents to 87 cents per package of 20 (from \$0.0185 to \$0.0435 per cigarette).

Tobacco Products

The excise tax rate on tobacco products increased to 61.53 percent of the wholesale cost of the tobacco products to the distributor. Tobacco products include all forms of cigars, smoking tobacco, chewing tobacco, snuff, and other products that contain at least 50 percent tobacco.

The 61.53 percent tax rate is a combination of the 35.36 percent resulting from the passage of Proposition 10 plus the current tax rate of 26.17 percent resulting from Proposition 99. The 61.53 percent tax rate will apply to all distributions of tobacco products during the

period January 1, 1999 to June 30, 1999. The Board will set the tobacco products tax rate for Fiscal Year 1999/00 in May 1999.

11. Are Cigarettes Marked "U.S. Exempt for Use Outside the U.S." (export product) Legal in California?

Subject to the conditions described below, it is legal to distribute and sell cigarettes in California that are marked as an export product.

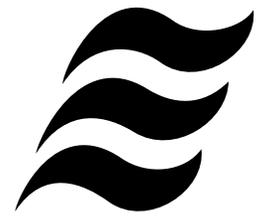
The cigarette packages must have a California tax indicia (stamp) affixed to the bottom and must meet all the labeling requirements of the Federal Cigarette Labeling and Advertising Act (FCLAA).

The package of cigarettes must have one of the following four Surgeon General's Health Warning labels affixed to the package:

- SURGEON GENERAL'S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, And May Complicate Pregnancy.
- SURGEON GENERAL'S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks To Your Health.
- SURGEON GENERAL'S WARNING: Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, And Low Birth Weight.
- SURGEON GENERAL'S WARNING: Cigarette Smoke Contains Carbon Monoxide.

In addition, the importer/distributor must have an approved rotation plan on file with the Federal Trade Commission that describes how each of the four warning labels will be used during the year for each brand of cigarettes to be sold.

A cigarette distributor is prohibited from placing a cigarette tax stamp on packages of cigarettes that do not meet the requirements of the FCLAA. The Board may revoke the distributor's license of any dis-



tributor that affixes cigarette tax stamps on any package of cigarettes that does not meet all the requirements of the FCLAA.

Cigarette retailers can verify that each package of export product purchased for resale includes a California cigarette tax stamp and one of the four approved Surgeon General's Health Warnings.

While the Cigarette and Tobacco Products Tax Law does not authorize the Board to take any action against retailers solely because they sell packages of cigarettes that do not conform to the requirements of the FCLAA, retailers should be aware that they may be cited under California Penal Code Section 308.2 for selling such cigarettes.

12. Underground Storage Tank Maintenance Fee

Do you operate a retail location that sells gasoline or diesel fuel or do you perform lubrication services or oil changes at your business? Do you own an underground storage tank and store petroleum products in your tank? If so, you are responsible for paying the Underground Storage Tank Maintenance Fee (UST fee).

The UST fee is based on the number of gallons of petroleum products placed into your tanks. Petroleum products include, but are not limited to, gasoline, diesel, kerosene, motor oil, and waste motor oil.

Because the tank owner is responsible for paying the fee, it is important to have documentation that establishes who is the owner. For example, records could include tank installation contracts, lease contracts, Underground Storage Tank Permit Applications (forms A, B, and C) filed with the local permitting agency or the State Water Resources Control Board, depreciation of the underground storage tank on federal and state income tax returns, or any other documentation indicating ownership.

Without documentation to the contrary, the Board will generally presume that the owner of the real property on which the tank is located is the owner of the underground storage tank.

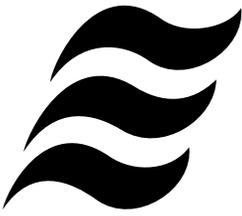
If you own an underground storage tank and are not registered to pay the UST fee, please contact the Fuel Taxes Division at 916-322-9669 or 1-800-400-7115 (follow the prompts) to start the registration process. If you are the operator and not the owner of an underground storage tank, be sure to provide a copy of this article to the owner so that the owner is made aware of his or her responsibilities to pay the fee.

13. Beer Imported into California Warehouses by Out-of-State Manufacturers and Vendors

Beer manufacturers and vendors who are located outside California are liable for the California excise tax on beer if they import the beer to California warehouses for temporary storage before it is sold to distributors.

The amount of time the product stays at the warehouse does not affect the tax liability. The manufacturer or vendor is considered the legal importer of the beer into California and is liable for the tax unless the product is shipped directly to the customer or the distributor at its California location and it is so stated on the bill of lading.

Agreements between the legal importer and distributor allowing the distributor to pay the tax to the Board is not binding to the state and does not relieve the importer from the liability for the excise tax.



14. New or Revised Reference Material

If you would like to obtain a copy of any of the following reference material, please call the Information Center. Copies can also be downloaded or viewed from our web site: <http://www.boe.ca.gov>.

Sales and Use Tax Publications

- 31 Tax Tips for Grocery Stores, 1-99
- 53 Guide to the Managed Audit Program, 11-98
- 68 Tax Tips for Photographers, Photo Finishers, and Film Processing Laboratories, 12-98
- 71 California City and County Sales and Use Tax Rates, 1-99

Sales and Use Tax Regulations

- 1585 Cellular Telephones, Pagers, and other Wireless Telecommunication Devices, effective February 12, 1999
- 1502 Computers, Programs, and Data Processing, effective January 29, 1999
- 1603 Taxable Sales of Food Products, effective January 9, 1999
- 1591 Medicines and Medical Supplies, Devices and Appliances, effective October 17, 1998
- 1593 Aircraft and Aircraft Parts, effective October 17, 1998
- 1703 Interest and Penalties, effective October 2, 1998

Law Pamphlets (January 1999)

- 1 Sales and Use Tax Law
- 2 Uniform Local Sales & Use Tax Law and Transactions & Use Tax Law
- 3 Use Fuel Tax Law
- 4 Cigarette Tax Law
- 19 Diesel Fuel Tax Law
- 49 California Underground Storage Tank Maintenance Fee Law
- 83 Tire Recycling Fee Law

How To Contact Us

Information Center. Call at any time to use our automated services, including our fax-back service. To speak to a representative, call between 8:00 a.m. and 5:00 p.m., Monday through Friday, excluding State holidays.

1-800-400-7115

Telephone devices for the deaf

1-800-735-2929 (TDD phone)

1-800-735-2922 (voice phone)

Internet. Visit us at <http://www.boe.ca.gov> to obtain information on tax rates, publications, legislation, regulations, telephone numbers, education programs, public meetings, and so forth.

Seller's Permit Verification. To verify permit numbers, call our automated voice response system at 1-888-225-5263 or visit our website at <http://www.boe.ca.gov>.

Taxpayers' Rights Advocate. Call the Advocate's office if you need help with a problem you have been unable to resolve at other levels, **1-888-324-2798** (toll-free).

Tax Evasion Hotline. Call to report suspected tax evasion, **1-888-334-3300** (toll-free).

Copies of Legislative Bills. Write to the Legislative Bill Room, State Capitol, Room B-32, Sacramento, CA 95814. Or visit the following website: <http://www.leginfo.ca.gov>. The Bill Room does not provide copies of Board forms or publications.