STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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July 25, 2016

VIA INTERNET

Dear Interested Party:

The Audit Manual (AM) is a guide for the Board of Equalization (BOE) staff in administering tax and fee programs. It is available to the public and can be accessed from the BOE web page at http://www.boe.ca.gov/sutax/staxmanuals.htm.

The Business Tax and Fee Department (BTFD) is proposing to revise the following AM Chapters:

- Chapter 4, *General Audit Procedures*
- Chapter 4, *Exhibit 20* (new Exhibit)
- Chapter 9, *Grocers*
- Chapter 12, *Construction Contractors*

The revision material is provided on the following pages for the convenience of interested parties who may wish to submit comments or suggestions. Please feel free to publish this information on your website or otherwise distribute it to your association/members.

If you have any comments or suggestions related to the proposed AM revisions, you may contact the BOE at AM.RevisionSuggestions@boe.ca.gov. Your comments or suggestions must be received by BOE no later than **September 26, 2016**, in order to be considered by staff. Thank you for your consideration.

Sincerely,

for Chief, Tax Policy Division
Business Tax and Fee Department

AUDIT MANUAL CHAPTER 4,
GENERAL AUDIT PROCEDURES

PARTIAL EXEMPTIONS 0422.00

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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.

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%~~

750,000 = 73.62%

750,000 + 250,000 + 18,~~125~~ 750 (7.50~~25~~% x 250,000)

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~~grocers 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.

SAMPLE JURIS GRID – PARTIAL EXEMPTION FOR MANUFACTURING AND RESEARCH & DEVELOPMENT EQUIPMENT EXHIBIT 20

R C	A	B	C	D	E	F	G	H	I		K
REF	JURISDICTION (FUND CODE)	STATE	LRF (904)	ASUT (057)	LPSF (056)	SLRF (055)	SCHL (908)	LOCAL	COUNTY	STJ	Total Rate
1	Full Rate	4.7500%		0.2500%	0.5000%	0.5000%	0.2500%	1.0000%	0.2500%		7.5000%
2	Partial Rate Exempt	4.7500%	-1.0625%	0.2500%			0.2500%				4.1875%
	Partial Rate Taxable		1.0625%		0.5000%	0.5000%		1.0000%	0.2500%		3.3125%
3	AUDIT SCENARIOS										
4	**ONE ERROR IN AUDIT**										
5	Sale subject to partial exemption not reported & included in audit		1,000		1,000	1,000		1,000	1,000	1,000	
6	Sale subject to partial exemption not claimed; credit allowed	-1,000	1,000	-1,000			-1,000				
7	Partial exemption disallowed	1,000	-1,000	1,000			1,000				
8											
9	**MULTIPLE ERRORS IN AUDIT**										
10	Unreported ex-tax purchases	1,000		1,000	1,000	1,000	1,000	1,000	1,000	1,000	
11	Sale subject to partial exemption not reported & included in audit		1,000		1,000	1,000		1,000	1,000	1,000	