



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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State Controller, Sacramento

TIMOTHY W. BOYER  
Interim Executive Director

November 14, 2003

Dear Interested Party:

Enclosed is the *Initial Discussion Paper on Documentation to Support Sales to the federal government, Regulation 1614, Sales to the United States and its Instrumentalities*. Discussion regarding proposed amendments to Regulation 1614 is scheduled for the Board's **March 23, 2004, Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 a.m. on December 3, 2003**, at the Board of Equalization; 450 N Street; Sacramento, California.

If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the December 3 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on December 3, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Mr. Todd MacMurray at 916-324-2900 or by e-mail at [todd.macmurray@boe.ca.gov](mailto:todd.macmurray@boe.ca.gov) prior to November 25, 2003. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing. In addition, please let Mr. Todd MacMurray know if you wish to have future correspondence, including the second discussion paper and all attachments, sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written preliminary responses to staff's analysis is **December 22, 2003**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact me at (916) 324-1825.

Sincerely,

Charlotte Paliani  
Tax Policy Manager  
Sales and Use Tax Department

CP: tdm

Enclosures

cc: (all with enclosures)  
Honorable Carole Migden, Chairwoman  
Honorable Claude Parrish, Vice Chairman  
Honorable Bill Leonard, Member, Second District (MIC 78)  
Honorable John Chiang, Member, Fourth District  
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel  
Ms. Carole Ruwart, Board Member's Office, First District (MIC 71)  
Ms. Sabina Crocette, Board Member's Office, First District  
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)  
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)  
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)  
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)  
Mr. Tim Treichel, Board Member's Office, Second District (via e-mail)  
Mr. Michael Thomas, Board Member's Office, Fourth District (MIC 72)  
Ms. Sylvia Tang, Board Member's Office, Fourth District (MIC 72)  
Mr. Timothy Boyer (MIC 73)  
Acting Chief Counsel (MIC 83)  
Mr. Ramon J. Hirsig (MIC 43)  
Ms. Janice Thurston (MIC 82)  
Mr. Warren Astleford (MIC 82)  
Mr. Randy Ferris (MIC 82)  
Ms. Trecia Nienow (MIC 82)  
Ms. Jean Ogrod (via e-mail)  
Mr. Jeff Vest (via e-mail)  
Mr. David Levine (MIC 85)  
Mr. Steve Ryan (via e-mail)  
Ms. Jennifer Willis (MIC 70)  
Mr. Dave Hayes (MIC 67)  
Mr. Joseph Young (via e-mail)  
Mr. Vic Anderson (MIC 40 and via e-mail )  
Mr. Larry Bergkamp (via e-mail)  
Mr. Geoffrey E. Lyle (MIC 50)  
Ms. Laureen Simpson (MIC 50)  
Mr. Todd MacMurray (MIC 50)  
Mr. Charles E. Arana Jr. (MIC 50)

# INITIAL DISCUSSION PAPER

## Documentation to Support Sales to the Federal Government, Regulation 1614, Sales to the United States and its Instrumentalities

### Issue

Should Regulation 1614 be amended to update the list of acceptable documents for supporting claimed exempt sales to the U.S. government?

### Background

Regulation 1614, *Sales to the United States and its Instrumentalities* (see Exhibit 1), states in subdivision (a) that sales tax does not apply to sales to:

1. The United States or its unincorporated agencies and instrumentalities.
2. Any incorporated agency or instrumentality of the United States wholly owned by either the United States, or by a corporation wholly owned by the United States.
3. The American National Red Cross, its chapters and branches.
4. Incorporated federal instrumentalities not wholly owned by the United States, unless federal law permits taxing the instrumentality.

Subdivision (g) of Regulation 1614, Supporting Documents (added to the regulation in August 1965), states: “Any seller claiming a transaction as exempt from tax under [Revenue and Taxation Code (RTC)] Section 6381 must obtain from the purchaser, and retain, a government purchase order or a government remittance advice to support his claim.”

### GSA SmartPay

Beginning November 30, 1998, the U.S. government began issuing its employees credit cards for making purchases under a new program called “GSA SmartPay.”<sup>1</sup> In February 1999, the Board sent taxpayers a Special Notice titled “U.S. Government Approves New Credit Cards for Official Purchases.” (See Exhibit 2.) The Special Notice described the different types of government credit cards and explained that claimed sales to the United States were exempt from tax if billed directly to the federal government and taxable if billed to the federal employee. The Special Notice also discussed documentary evidence required to support exempt sales to the U.S. government. In January 2000, the Audit Manual was updated to reflect these changes. (See Exhibit 3.)

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<sup>1</sup> The GSA SmartPay program began November 30, 1998, under a five-year contract. The U.S. government plans to renew the contract and continue the GSA SmartPay program through 2008.

# INITIAL DISCUSSION PAPER

## Documentation Provided to Support Sales to the Federal Government, Regulation 1614, Sales to the United States and its Instrumentalities

### Discussion

District audit staff have raised concerns regarding what constitutes acceptable documentation for supporting exempt sales to the U.S. government. There appears to be confusion as to how a vendor may support a claimed exempt sale to the U.S. government since the federal government's purchasing practices have changed since subdivision (g) of Regulation 1614 was promulgated. For example, the regulation has not been updated to reflect the GSA SmartPay program.

### Audit Manual Provisions

Audit Manual Section 0410.10, Auditing Procedure, states "Documentary evidence required to support the deduction, where the sale is made directly to the United States [g]overnment, a subdivision or agent, should consist of one or more of the following documents:

- Purchase orders
- Remittance advices
- Copy of U.S. [g]overnment credit card or credit card number
- Shipping and other documents if there is a question whether the merchandise was sold directly to an individual who is in the armed services."

### Confusing Terminology

Board staff generally interpret the term "remittance advice," as used in the regulation and Audit Manual, as either (1) a copy of a payment check or (2) the check stub (when the payor uses a two part check). However, staff believes that the term "remittance advice" is not commonly understood among the general public, which may cause confusion for taxpayers. For example, an online accounting dictionary at VentureLine.com (a leading Web-based accounting dictionary) does not define the term "remittance advice." Moreover, the U.S. government procures all services and supplies in accordance with the Federal Acquisition Regulations (FAR). FAR does not use the term "remittance advice."

Accordingly, staff recommends a Rule 100<sup>2</sup> change to subdivision (g) of Regulation 1614,

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<sup>2</sup> Under Rule 100 of California's Administrative Procedures Act, under certain circumstances, an agency may add to, revise, or delete text in a regulation without observing all the steps usually required to amend a regulation (e.g., a public hearing need not be held). One set of circumstances under which such a streamlined approach may be taken occurs when the proposed change in the regulation does not materially alter any requirement, right, responsibility, condition, prescription or other regulatory element. As with other proposed regulatory changes, "Rule 100" changes are subject to the approval of the Office of Administrative Law.

## **INITIAL DISCUSSION PAPER**

### **Documentation Provided to Support Sales to the Federal Government, Regulation 1614, Sales to the United States and its Instrumentalities**

substituting the phrase “documents demonstrating direct payment by the United States” for the term “government remittance advice.”

#### **Summary**

Staff believes Regulation 1614 should be amended to clarify outdated language that no longer pertains to current U.S government purchasing practices, and welcomes suggestions from affected interested parties.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 11/13/03.

Initial Discussion.doc rev. 9-30-03

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**Regulation 1614. SALES TO THE UNITED STATES AND ITS INSTRUMENTALITIES.**

Reference: Section 6381, 6381.5, Revenue and Taxation Code.

**(a) GENERALLY.** Sales tax does not apply to sales to:

- (1) The United States or its unincorporated agencies and instrumentalities.
- (2) Any incorporated agency or instrumentality of the United States wholly owned by either the United States, or by a corporation wholly owned by the United States.
- (3) The American National Red Cross, its chapters and branches.
- (4) Incorporated federal instrumentalities not wholly owned by the United States, unless federal law permits taxing the instrumentality. Examples of incorporated federal instrumentalities exempt from tax are federal reserve banks, federal credit unions, federal land banks, and federal home loan banks.

Application of the use tax to the storage, use, or other consumption of tangible personal property by agencies or instrumentalities of the United States is prohibited unless federal law permits taxing the agency or instrumentality.

Where payment for tangible personal property sold or consumed in this state is made partly by the United States or its instrumentalities and partly by nonexempt persons, the payment is exempt to the extent of the United States' or its instrumentality's share provided it is made directly to the vendor by the United States or its instrumentality. If the nonexempt party makes full payment and then seeks reimbursement from the United States or its instrumentality, the entire amount is taxable even though the United States or its instrumentality may reimburse him in full or in part.

**(b) ARMY AND AIR FORCE EXCHANGE SERVICES, NAVY EXCHANGES, COAST GUARD EXCHANGES, OPEN MESSES, AND OFFICERS' MESSES.** Army and air force exchange services, navy exchanges, coast guard exchanges, open messes, and officers' messes, established pursuant to regulations of the appropriate branch of the armed services are instrumentalities of the United States, and tax does not apply to sales to these organizations.

Tax applies to sales to persons in the armed services of the United States, notwithstanding the circumstance that the merchandise may be billed through any army or air force exchange service, navy exchange, coast guard exchange, or similar organization.

**(c) COMPANY AND OTHER UNIT FUNDS.** Tax does not apply to sales to the armed services of merchandise purchased with unit and similar funds (company, troop, hospital, recreation, welfare, etc.) where the expenditures are made in accordance with appropriate regulations of the armed services for the general benefit of armed services personnel.

**(d) CIVILIAN WELFARE FUNDS.** Civilian welfare funds are established and administered under armed services regulations under which post restaurants are also administered. Both are nonappropriated fund activities and are unincorporated governmental instrumentalities. Accordingly, sales tax does not apply to sales made to such organizations properly conducted and operated at military installations in this state in accordance with appropriate regulations.

Any seller to such organizations claiming a transaction as exempt from sales tax must obtain from the purchaser a certificate similar to the following:

This is to certify that the \_\_\_\_\_  
(Name of Fund)

located at \_\_\_\_\_ is a nonappropriated  
(Name of Installation)

fund activity located at a military installation of the United States in the State of California and is conducted and operated in accordance with armed services regulations established for such activities. As such, sales to this nonappropriated civilian welfare fund are exempt from California state and state-administered local sales taxes.

\_\_\_\_\_  
Signature of Commanding Officer or Representative

\_\_\_\_\_  
Print or Type Name

\_\_\_\_\_  
Rank

\_\_\_\_\_  
Date

**(e) The Selective Service System.** Tax does not apply to receipts from sales, other than leases, to State Procurement Officers for selective service authorized by selective service regulations.

**(f) Medicare Program.** Tax does not apply to the sale of items to a person insured pursuant to Part A of the Medicare Act as such sales are considered exempt sales to the United States.

Tax applies to the sale of an item to a person insured pursuant to Part B of the Medicare Act even though the person assigns the claim for reimbursement to the retailer and the retailer files the claim with, and is paid by, a carrier administering medicare claims under contract with the United States.

**(g) Supporting Documents.** Any seller claiming a transaction as exempt from tax under Section 6381 must obtain from the purchaser, and retain, a government purchase order or a government remittance advice to support his claim.

# Special Notice

## U.S. Government Approves New Credit Cards for Official Purchases

Are you aware that some charges are subject to tax?

STATE BOARD  
OF EQUALIZATION

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California 95814

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E.L. SORENSEN, JR.  
Sacramento

### New Cards Approved

On November 30, 1998, the U.S. government issued the following new credit cards to government cardholders: MasterCard, VISA, and Voyager. All cards are imprinted with the words "United States of America" and "For Official Government Use Only." They replace the VISA IMPAC, American Express, Discover, and Wright Express cards, which were previously used for U.S. government purchases.

### How To Identify Exempt Charges

The types of charges that can be made using U.S. government credit cards are listed below. Charges for the first two categories are billed directly to the federal government and are exempt from California sales or use tax. Charges for the third category - travel-related charges - may or may not be billed directly to the government and may be subject to tax.

See also note below for purchases made by Bureau of Reclamation cardholders.

- **FLEET PURCHASES (EXEMPT FROM TAX)**  
Purchases of fuel, oil, services, maintenance and repair for government-owned or leased vehicles, aircraft, and boats.
- **OPERATING PURCHASES (EXEMPT FROM TAX)**  
Purchases of day-to-day operating supplies.
- **TRAVEL-RELATED PURCHASES (MAY BE SUBJECT TO TAX)**  
Purchases of car rentals, lodging, meals, drinks, common carrier transportation, and so forth, for official travel and travel-related expenses. If the charge is billed directly to the U.S. government, the charge is exempt. You can determine this by looking at the 6th digit of the 16-digit account number. If the 6th digit is 0, 6, 7, 8, or 9, the charge is billed to the government and is exempt. If the 6th digit is 1, 2, 3, or 4, the charge is billed to the federal employee and is subject to tax.

**Note-Bureau of Reclamation purchases.** All purchases made with U.S. government credit cards provided by Bureau of Reclamation employees, including all travel-related charges, are billed directly to the federal government and are exempt from tax. Retailers should obtain proof of Bureau employment to document the exemption.

### Documentation Required

You should retain the credit card receipt containing the imprint of the card, with the account number clearly legible, and the sales invoice to support an exempt sale to the U.S. government. If the purchase is made by telephone, you should note the credit card number and the purchaser's name on the credit card receipt. If the purchase is made by a Bureau of Reclamation employee, you should also obtain documentation showing employment with the Bureau, such as a business card or employee identification card.

The credit card companies that issue the cards are under contract with the U.S. government and are responsible for appropriately billing either the U.S. government or the federal employee. Retaining a legible copy of the credit card receipt is therefore critical to establish how the billing should have been made.

### For More Information

Please call our Information Center, 1-800-400-7115. Staff are available from 8:00 a.m. to 5:00 p.m., Monday through Friday, excluding State holidays.

February 1999

**GENERAL AUDIT PROCEDURES** *January 2000***AUDITING PROCEDURE 0410.10**

An audit of this deduction should be made in the same manner as an audit of a deduction for sales for resale. Ordinarily the number of such sales is limited and the audit should be made on a complete basis. If, however, the number of items claimed is exceptionally large and the average unit of sale is comparatively small, a test basis may be used. Documentary evidence required to support the deduction, where the sale is made directly to the United States Government, a subdivision or agent, should consist of one or more of the following documents:

- Purchase orders
- Remittance advices
- Copy of U.S. Government credit card or credit card number
- Shipping and other documents if there is a question whether the merchandise was sold directly to an individual who is in the armed services

In the absence of documentation to support claimed sales to the U.S. Government, the auditor may determine that it is appropriate for a seller to use the BOE-504 series of forms (BOE-504-CUS) procedure to help satisfy their burden of proving that a sale was not at retail even though exempt documentation was not obtained (See section 0409.51 for procedures).

Sales to contractors who are engaged in work on projects owned by the United States Government are not sales to the Government. If the contractor is actually selling tangible personal property to the U.S. Government, such sales are sales for resale and should be verified as such. Mention is made of this in this section only because many retailers classify such sales as sales to the United States Government and erroneously claim the deduction under that heading rather than sales for resale. If the auditor has reason to believe the material purchased was not actually sold by the contractor-customer to the U.S. Government, a Form BOE-1164, Audit Memorandum of Possible Tax Liability (0401.20), should be prepared setting forth all pertinent phases of the transaction.

**SALES TO FEDERAL EMPLOYEES USING U.S. GOVERNMENT  
BANKCARDS 0410.15**

The federal government issues credit cards to its employees for purchases of goods and services. Beginning November 30, 1998, the purchases are under a new program called "GSA SmartPay" and is effective for 5 years. Cards will now be issued by Citibank, First National Bank of Chicago, NationsBank, Mellon Bank, and U.S. Bank. The new cards bear 16-digit account numbers with unique prefixes, government designed artwork, and are imprinted with "United States of America" at the top. In the right-hand corner, cards contain a logo which says "SmartPay". The cards also bear wording that denotes the card is for "Official Government Use Only". The General Services Administration administers the program for all departments and agencies of the U.S. Government.

Purchases made with most of the new cards are directly billed to the government and will represent nontaxable sales to the U.S. Government. Those purchases directly billed to the employee are subject to sales tax. To determine which government credit cards are government-billed and which are employee-billed, retailers will have to consider the type of card, the type of transaction, and the card account numbers. Generally, through use of the Bankcard System and coding authorization, purchases are automatically denied if a particular type of card is used to make a type of purchase for which that card was not issued.

For FLEET CARDS, there are two types of U.S. Government “fleet” cards which may be issued to federal employees to make fleet type purchases (e.g., gasoline, oil, etc.). One is a Voyager card and the other is a MasterCard. They Voyager cards contain 16-digit account numbers that start with the prefix 8699. The MasterCard card contains 16-digit account numbers that start with the prefix 5568. All fleet type purchases made with these cards are billed directly to the U.S. Government and are not taxable.

For PURCHASE CARDS, there are two types of U.S. Government “purchase” cards which may be issued to federal employees to make purchases of goods (e.g., office supplies, parts, etc.). One is a VISA card and the other is a MasterCard. The Visa card contains 16-digit account numbers that start with the prefix 4486 or 4716. The MasterCard cards contain 16-digit account numbers that start with the prefix 5568. All purchases of goods made with these cards are bill directly to the U.S. Government and are not taxable.

For TRAVEL CARDS, there are two types of U.S. Government “travel” credit cards which may be used by federal employees to make travel type purchases (e.g., hotels, car rentals, restaurants, etc.). One is a VISA card and the other is MasterCard. The Visa card contains 16-digit account numbers that start with the prefix 4486 or 4716. The MasterCard cards contain 16-digit account numbers that start with the prefix 5568. Federal government travel cards may either be billed to the U.S. Government or to the federal employee depending upon the account number. If purchases made with travel cards are billed to the employee, the sales are subject to tax. To determine whether purchases made with federal government travel cards are government-billed or employee-billed, retailers must look at the 6<sup>th</sup> digit of the account number of the card. If the 6<sup>th</sup> digit is 1, 2, 3, or 4, purchases are billed to the employee and are taxable. If the 6<sup>th</sup> digit is 0, 6, 7, 8, or 9, purchases are billed to the U.S. Government and are not taxable. This procedure applies to both VISA and MasterCard travel cards.

In some instances, some federal agencies will issue INTEGRATED CARDS for the purpose of “fleet,” “property,” and “travel” purchases. These cards are provided by MasterCard and contain a 16-digit account number that starts with 5568–16. All fleet and property purchases made with these cards are billed directly to the U.S. Government and are not taxable. However, travel purchases may be either government-billed or employee-billed depending upon the account number. To determine whether travel purchases are government-billed or employee-billed, retailers must again look at the 6<sup>th</sup> digit of the account number of the card. If the 6<sup>th</sup> digit is 1, 2, 3, or 4, purchases are billed to the employee and are taxable. If the 6<sup>th</sup> digit is 0, 6, 7, 8, or 9, purchases are billed to the U.S. Government and are not taxable.

Exception: All purchases made with integrated MasterCard credit cards provided by the Bureau of Reclamation employees, including travel purchases, are billed directly to the U.S. Government and are thus exempt from tax. Bureau of Reclamation employees will have to identify themselves to the retailer and show proof of Bureau employment to obtain the exemption.

Retailers who make U.S. Government credit card sales should retain the credit card receipt containing the imprint of the credit card and the sales invoice to support exempt transactions to the U.S. Government. If the purchase is by telephone, the retailer should note the credit card account number and purchaser’s name on the credit card receipt.