



TAX Information

B · U · L · L · E · T · I · N



Publication 388

www.boe.ca.gov

December 2009

The purpose and benefits of responding to XYZ letters

In absence of any valid resale documentation or evidence of tax payment to the Board of Equalization (BOE), an auditor may determine that it is appropriate for a seller to use the BOE-504 series of forms (called XYZ letters) to help satisfy the seller's burden of proving that a sale was not at retail even though a valid resale certificate was not obtained or to confirm a claim that the purchaser paid the tax directly to the state. The BOE offers the option of using XYZ letters to indicate the character of property and application of tax. This process helps us determine if the use tax has already been reported or if the seller's sale was a sale for resale. When the BOE accepts the purchaser's response to an XYZ letter as a valid response, the BOE shall relieve the seller of liability for sales tax or use tax collection. An XYZ letter is not to be treated as a resale certificate in the sense of relieving a seller from liability for sales tax (additional documentation or information may be required).

Responding to an XYZ letter benefits the seller, the purchaser, and the state.

Responding to an XYZ letter may relieve the seller of liability for sales tax or use tax collection and penalties.

Responding to an XYZ letter benefits the purchasers by helping to maintain professional business relationships with their vendors. It will also help ensure that the proper amount of tax is paid to the state.

One of the most important benefits to the XYZ letter is that it enables the BOE to assess tax against the proper party while at the same time avoiding the assessment of tax against both the seller and purchaser.

For additional information please visit www.boe.ca.gov or contact our Taxpayer Information Section at 800-400-7115.

Are you required to be registered to report use tax?

Because of a recent change in the California Sales and Use Tax Law, you may now be required to register with the BOE for purposes of reporting and paying use tax. Although the obligation to report and pay use tax has been in effect since 1935, the registration requirement for certain purchasers is new.

In general, use tax applies to purchases of merchandise from out-of-state sellers (both foreign and domestic) for storage, use, or other consumption in California. If the out-of-state seller does not collect use tax on your purchase, then you must pay the applicable use tax directly to the BOE. This is true whether the purchases were made in person, over the Internet, by telephone, or by mail order. If an out-of-state seller charges you California tax, you should be sure to obtain a receipt. The use tax rate for any location is the same as the sales tax rate and applies to the purchase price of the property.

Assembly Bill X4-18 added section 6225 of the Revenue and Taxation Code, which requires "qualified purchasers" to register with the BOE and report and pay the use tax annually. A "qualified purchaser" is defined as a person who:

- Is not required to hold a seller's permit,
- Is not required to be registered with BOE under Revenue and Taxation Code section 6226,
- Receives at least \$100,000 in gross receipts from business operations (includes both in-state and out-of-state operations) per calendar year,
- Does not hold a use tax direct payment permit, and
- Is not otherwise registered with the BOE to report use tax.

Section 6225 of the Revenue and Taxation Code does not apply to purchases of vehicles, vessels, or aircraft.

BOARD MEMBERS

BETTY T. YEE
First District
San Francisco

BILL LEONARD
Second District
Ontario/Sacramento

MICHELLE STEEL
Third District
Rolling Hills Estates

JEROME E. HORTON
Fourth District
Los Angeles

JOHN CHIANG
State Controller

EXECUTIVE DIRECTOR
RAMON J. HIRSIG

Returns for reporting use tax on purchases made during a calendar year for qualified purchasers are due by April 15 of the following year. Earlier this year, the BOE began contacting potential qualified purchasers for registration. If you are a qualified purchaser and have not been contacted by the BOE, please contact our Taxpayer Information Section at 800-400-7115 and speak with one of our representatives.

For additional information, please refer to [publication 123](#), *California Businesses: How to Identify California Use Tax Due*, [publication 110](#), *California Use Tax Basics*, and [publication 112](#), *Purchases from Out-of-State Vendors*, available at www.boe.ca.gov and also from our Taxpayer Information Section.

Are bad debts deductible?

If you have reported a taxable sale and have been unable to collect full payment for the sale, you may claim a deduction for the bad debt on your sales and use tax return. The Sales and Use Tax Law does allow a deduction for “bad debts,” if specific criteria are met.

In general, you can claim deductions for checks returned unpaid by the purchaser’s bank that you have determined to be uncollectible, or accounts from charge or credit sales found worthless. The bad debts must be charged off for income tax purposes, or if you are not required to file income tax returns, or file income tax returns on a cash basis, the bad debts must be charged off in accordance with generally accepted accounting principles.

You may deduct the taxable portion of the uncollected debt on your sales and use tax return, under “Bad Debt Losses on Taxable Sales.” If you do not deduct the bad debt on the proper sales and use tax return, you cannot deduct it on a subsequent return. Instead, you must file a claim for refund for the amount of tax overpaid (generally you must file the claim within three years from the date in which you could have properly claimed the deduction on your return).

You may not, however, deduct the expenses incurred in attempting to collect the unpaid amount from the customer, nor can you deduct the portion of any unpaid amount collected and retained by a collection agency.

Sometimes, your uncollectible sale is comprised of both taxable and nontaxable items. When this is the case, you must either eliminate the nontaxable portions prior to claiming the deduction, or prorate the entire unpaid amount to arrive at the taxable percentage, using one of the methods specified in [Regulation 1642](#), *Bad Debts*.

Example: A customer writes a bad check to an auto mechanic in the amount of \$358.25 to pay for a \$100 taxable sale of repair parts, a \$250 nontaxable sale of repair labor, and tax of \$8.25 (assume a 8.25 percent tax rate). The auto mechanic subsequently collects \$50 cash from the customer and writes off the remaining \$307.25 debt. The amount of the bad debt that may be claimed on the mechanic’s sales and use tax return is \$86 ($\$100 \div 357.25 = 28\%$; $28\% \times \$307.25 = \86).

If you later collect payment from a customer for whom you have previously claimed a bad debt deduction, you must then report and pay the taxable portion (or percentage) of the amount collected in the first return filed in after such collection was received.

You should maintain the following information and records to support a bad debt deduction:

- Date of the original sale
- Name and address of the purchaser
- Amount purchaser contracted to pay
- Amount on which you, the retailer paid tax
- All payments or other credits applied to the purchaser’s account
- Evidence that the debt has been properly charged-off on income tax returns or—if you are not required to file income tax returns or if you file income tax returns on a cash basis—in a manner consistent with generally accepted accounting principles

If you are a lender, or are involved with the repossession of vehicles or other property, please refer to the additional requirements in Regulation 1642, or call our Taxpayer Information Section for assistance at 800-400-7115.

You must have your cigarette and tobacco products license in hand to start business

The California Cigarette and Tobacco Products Licensing Act of 2003 (the Act) requires that every business that sells, or purchases for sale, cigarettes and/or tobacco products must first be licensed by the BOE. Even though you may have submitted an application and the licensing fee to the BOE, you cannot legally sell cigarettes or tobacco products until you receive your Cigarette and Tobacco Products License. Any sales or purchases for resale of cigarettes or tobacco products without a valid license constitutes a violation of the Act, which may result in a seizure of your product, assessment of a penalty and/or a fine. For more information please visit www.boe.ca.gov.

Prepayment reminder for all generator fee account holders

If your generator account is on prepayment status and you made the January and June 2009 prepayments, be sure to claim the prepayment amounts as a credit on your annual generator return, due February 28, 2010. If you forget to take credit for your prepayment, it could be months before the error is discovered and the monies refunded. If you have any questions or are unsure if you made a prepayment you can call the Environmental Fees Division—Hazardous Substances Section at 916-322-9534 for assistance. Please have your account number (HG EF 36-XXXXXX) handy so we can quickly retrieve your account information.

Dyed diesel fuel notice required to be posted on retail sales pumps

The Diesel Fuel Tax Law requires that a notice stating “Dyed Diesel Fuel, Nontaxable Use Only, Penalty for Taxable Use” be posted by a seller on any retail pump dispensing dyed diesel fuel, and imposes a penalty for the failure to do so. The notice should be posted on the pump to ensure the purchaser of the fuel can see it prior to dispensing fuel from the pump into the fuel tank of their vehicle.

If a notice is not properly posted, the amount of the penalty for the first violation is a minimum of \$1,000 but increases to \$10 per gallon for each gallon of dyed diesel fuel sold through the pump, if it is determined that more than 100 gallons were sold. The \$1,000 penalty increases for each subsequent violation by the number of prior violations and the greater of this amount or the \$10 per gallon would be assessed. Each officer, employee or agent of the business entity who participated in any act giving rise to the penalty is jointly and separately liable for the penalty. The failure by the seller to post the required notice creates a presumption that it knows the diesel fuel will be used in a taxable manner. The seller of the dyed diesel is also subject to the backup tax of \$0.18 for each gallon of dyed diesel fuel sold through the pump.

The law provides penalties for both the seller and purchaser if the dyed diesel fuel is used in a taxable manner and the seller had prior knowledge of this fact. The penalty provisions also apply to dyed diesel fuel placed in bulk storage and later used in a taxable manner. If you have questions about the sales of dyed diesel fuel, please contact the Fuel Taxes Division at 916-322-9669.

Are photographs or videos for noncommercial use taxable?

Many people erroneously consider services related to shooting photographs or videos to be labor charges that are not subject to tax.

If you are in the business of shooting photographs or videos for noncommercial use, the taxable amount of your charge to your customers will generally include all of the following:

- Charges for the physical product you transfer to your customer
- Any labor and services involved in producing or fabricating the photograph or video
- Any reproduction rights associated with the photograph

Noncommercial use is considered private use, such as family portraits, wedding photographs and videos, or school portraits. It does not include commercial use where the images are intended for promotion, publicity, marketing, publishing, advertising, or commercial display, etc.

Here are some of the common examples related to non-commercial use:

The first example involves the sale of a photography package for a family portrait including the services (sitting fee) of a photographer and a photo album with prints.

Tax applies to charges for the entire package including charges for a photographer’s time because the sale of the package involves the transfer of tangible personal property (merchandise) and services of a photographer related to the taxable sale of tangible personal property. No deduction is allowed for salaries or wages paid to the photographer, whether or not such expenses are itemized on an invoice to the customer.

The second example involves the sale of videotapes of private events, such as weddings or graduations including the services of a camera operator and sales of DVD copies. The services consist of shooting and editing the events.

Such videos are not considered qualified motion pictures, as provided in [Regulation 1529](#), *Motion Pictures*, and therefore tax applies to the entire video package including the services of camera operator, editing, and the sales of DVDs.

The third example involves a deposit paid in advance of receiving the photography or video package.

The deposit is not subject to tax; tax is due on the full amount of the sale price on the date of the sale regardless of whether a deposit was received from your customer.

For more information please visit www.boe.ca.gov or call our Taxpayer Information Section at 800-400-7115.

Oil spill response, prevention, and administration fees law

Both the oil spill response fee and administration fee are imposed on a person who owns petroleum products received at a marine terminal within this state by means of a vessel from a point of origin outside this state. Only the \$0.05 per barrel administration fee is currently being imposed and is typically collected by a registered marine terminal operator from the owner of the petroleum product. For purposes of this fee law, petroleum products means any liquid hydrocarbon at atmospheric temperature and pressure that is the product of the fractionation, distillation, or other refining or processing of crude oil and that is used as, usable as, or may be refined as, a fuel or fuel blendstock, including, but not limited to, gasoline, diesel fuel, aviation fuel, bunker fuel and alcohol fuels containing petroleum products.

Any product resulting from the blending or commingling of a petroleum product with a non-petroleum product and shipped to a marine terminal in this state is considered a petroleum product for purposes of the Oil Spill Response, Prevention, and Administration Fees. For example, denatured alcohol, when the denaturant is a petroleum product or biodiesel that contains a petroleum product such as petroleum based diesel fuel are considered petroleum products subject to the fee.

Herbal products, including tea and tea capsules

This is a clarification to an article written in the June 2008 *Tax Information Bulletin* concerning sales of herbal products. That article stated,

Sales of herbal products, including teas and tea capsules are subject to tax if:

- Medicinal claims are made on the label or packaging, or in catalogs, brochures, or other informational material distributed with the products, or
- The products are labeled, packaged, or otherwise marketed as food supplements or adjuncts. (An adjunct is a food additive.)

Medicinal claims do not have to be made in English for tax to apply to the sale of the product. Accordingly, tax applies to sales of herbal products having no medicinal claim in English, but a medicinal claim is made in a foreign language on the label or packaging, or in catalogs, brochures, or other informational material distributed with the products.

For clarification regarding medicinal claims, a medicinal claim, on a product's label, does not convert a food product into a medicine. Products sold as medicines are not excluded from the definition of food products; actual medicines are. If the product falls within the definition of a medicine, then it is not a food product.

To determine if sales of herbal products, including teas and tea capsules, fall within the food products exemption, it is irrelevant if specific medicinal claims are made regarding the product; instead, the product must actually be a medicine.

When determining if a product is a medicine, it must first be determined if the product is approved for use by the U.S. Food and Drug Administration to diagnose, cure, mitigate, treat or prevent any disease, illness or medical condition. If a product is so approved, it is a medicine under [Regulation 1591](#), *Medicines and Medical Devices*, and is not a food product.

For additional information, please see [Regulation 1602](#), *Food Products*, and [Regulation 1591](#), *Medicines and Medical Devices*, available from www.boe.ca.gov or by calling our Taxpayer Information Section at 800-400-7115.

Underground storage tank maintenance fee

Tank owner responsibilities

Owners of underground storage tanks are required to register with the BOE for an underground storage tank account and are responsible for filing returns and paying the Underground Storage Tank Maintenance Fee even if someone else operates the tank. The fee is based on the number of gallons of petroleum products placed into their underground tanks.

Since the inception of the Underground Storage Tank Maintenance Fee, we have had difficulty identifying the owners of underground storage tanks. To eliminate confusion in identifying who is responsible for paying the fee, owners and operators should maintain clear documentation regarding ownership of the underground tanks. For example, records may include tank installation contracts,

lease contracts, underground storage tank permit applications filed with the local agency, and other documentation indicating ownership. Without documentation to the contrary, the BOE will generally presume that the owner of the real property on which the tank is located is the owner of the underground storage tank.

Statute of limitation is eight years for unregistered tanks

We have discovered unregistered tank owners as a result of information obtained from related sales and use tax audits, or when a subsequent owner registers a tank. In the case of failure to file a return, the statute of limitations for a notice of determination is eight years. Penalty and interest will also apply.

Owners of underground storage tanks are responsible for filing returns and payment of the fee. Underground storage tank operators who receive this newsletter but do not own the underground tanks can provide a copy of this article to the owner so the owner is made aware of his or her responsibility to pay the fee.

Please refer to [publication 88](#), *Underground Storage Tank Fee*, or call the BOE's Fuel Taxes Division at 916-322-9669.

Tax rate change for IFTA and Interstate User Diesel Fuel Licenses, 2010

The tax you normally report and pay with your quarterly fuel tax return for diesel fuel purchased outside California and used in this state has been decreased to 37.3 cents per gallon for the period January 1, 2010 through December 31, 2010. You may also claim a credit of 37.3 cents per gallon for the gallons of tax-paid diesel fuel purchased in California and used both inside and outside the state. The 37.3 cents per gallon reflects: 18 cents per gallon of diesel fuel tax, and an additional excise tax of 19.3 cents per gallon. (This rate is equal to 8.25 percent of the average retail price of motor vehicle fuel sold in California. This amount is calculated annually for the period January 1 through December 31.) If you have questions concerning this tax rate change, call the Motor Carrier Section at 916-322-9669 or call our Taxpayer Information Section.

Email encryption

Email encryption allows us to provide a safe and secure way of transmitting information electronically. Beginning in December 2009 we will be able to send our customers and stakeholders confidential information via email that is secure. Instructions for registering and receiving encrypted emails will be posted to our website. The process is quick and easy.

2010 annual Taxpayers' Bill of Rights hearings

Do you have suggestions for improving our services? Do you want us to look more closely at a tax or fee issue? If you do, come share your ideas and concerns with our Board Members at the annual Taxpayers' Bill of Rights hearings. You can present your proposal orally or in writing.

The annual business and property taxes hearings for 2010 will be held in Sacramento and in Culver City in the Spring of 2010. The dates and times were not yet set when this article went to press, but you may check our website or contact the Taxpayers' Rights Advocate for details.

Although you are not required to make advance arrangements to speak, it would help us to prepare if you contacted the Taxpayers' Rights Advocate Office at 888-324-2798 beforehand to let us know your topic. If your proposal is complex or extensive, we encourage you to submit it in advance and then summarize it in your oral presentation.

For more details, please call the Advocate Office or visit us at www.boe.ca.gov (mouse over the tab "Your Rights" then choose "Taxpayers' Rights Advocate"), where you can also view the office's 2008-09 annual report, which will be available soon.

Ethics at work—“thank you” is enough

We'd like to remind you that BOE policy prevents our employees from accepting gifts of any type. So if you're grateful to someone for going the extra mile to help you with a complicated issue, a simple "thank you" will do. You can also use our online Customer Service Survey form at www.boe.ca.gov/info/survey.htm to express yourself.

Online Learning and Educational Products

Announcing a new collection of online informational video and audio presentations. Topics include self paced presentations on how to efile, how nonprofit organizations qualify and file for property tax exemptions, how to prepare for an in person appeal hearing, and many other helpful virtual workshops with tips to assist you!

Please visit us at www.boe.ca.gov/info/video.htm.

New or revised reference material

- [Pub 21G](#) The California State Board of Equalization 7-09
- [Pub 49](#) California Underground Storage Tank Maintenance Fee Law 6-09
- [Pub 60](#) California Hazardous Substances Tax Law 6-09
- [Pub 69](#) California Integrated Waste Management Fee Law 6-09
- [Pub 71](#) California City and County Sales and Use Tax Rates Addendum 7-09
- [Pub 74](#) Closing Out Your Seller's Permit 6-09
- [Pub 83](#) California Tire Fee Law 6-09
- [Pub 142A](#) Appeals Conferences: An Introduction 10-09
- [Pub 24](#) Liquor Stores 8-09
- [Pub 29](#) California Property Tax: An Overview 8-09
- [Pub 51](#) Board of Equalization Resource Guide to Free Tax Products and Services 9-09
- [Pub 52](#) Vehicles and Vessels: How to Request a Use Tax Clearance for DMV Registration 8-09
- [Pub 89ST](#) EFT Quick Reference Guide for Special Taxes 8-09
- [Pub 102](#) Sales to the United States Government 8-09
- [Pub 107](#) Do You Need a California Seller's Permit 9-09
- [Pub 109](#) Internet Sales 8-09
- [Pub 115](#) Applying Sales Tax to Tips and Related Payments 8-09
- [Pub 142](#) California State Board of Equalization Hearings: An Introduction 10-09
- [Pub 151](#) Contribution Disclosure Statements 10-09
- [Pub 177](#) Internet Auction Sales and Purchases 8-09
- [Pub 329](#) Economic Perspective 8-09

Am I Responsible to Report and Pay District Taxes?

Voter-approved use taxes (district taxes) are imposed on the sale of tangible personal property in a district, and you are responsible for reporting and paying transactions tax if you are a retailer located in a district.

Generally, if a retailer located in Orange County takes an order and delivers the property to a location in Orange County, the retailer collects 8.75 percent, which includes the combined statewide rate of 8.25 percent and the 0.5 percent Orange County district tax. For example, your business is located in a district and you sell merchandise to a customer who is located in an area where there is no district tax. If your customer picks up the merchandise at your location, the sale is subject to your district's transactions (sales) tax, even if your customer intends to take the merchandise back to his or her location.

On the other hand, if you ship the property to the purchaser's location, the sale is not subject to your district's transactions (sales) tax.

If the retailer is not "engaged in business" in the district of delivery, and the property is not delivered by the retailer's own facilities, then the retailer is not required to report and pay the district tax. In such cases, the retailer is only be responsible for the combined statewide rate of 8.25 percent. The purchaser is required to report any district use tax due on the purchase.

For more detailed information, please see [Regulation 1823](#), *Application of Transactions (Sales) Tax and Use Tax*, [publication 44](#), *District Taxes*, and [publication 105](#), *District Taxes and Delivered Sales*, available from www.boe.ca.gov or by contacting our Taxpayer Information Section at 800-400-7115.

For More Information

All telephone numbers are toll-free.

Internet

www.boe.ca.gov
www.taxes.ca.gov

Taxpayer Information Section

800-400-7115
TDD/TTY: 800-735-2929

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/bilinfo.html

California State
Board of Equalization
PO Box 942879
Sacramento, CA 94279-0001