



# Tax Information Bulletin

STATE BOARD  
OF EQUALIZATION

ISSUED QUARTERLY  
June 2001

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## 1. Reporting "Purchases Subject to Use Tax"

### Common Errors Discovered in Audits

Most businesses understand when they must report and pay sales tax, but they aren't so sure what

to do when it comes to use taxes. One of the most common reporting errors occurs on line 2 of the sales and use tax return, "Purchases Subject to Use Tax."

### Just what is the "use" tax?

Use tax generally applies to the *use* in this state of tangible personal property that has been purchased without payment of California sales tax. Use tax does not apply to property that is used only for demonstration and display while being held for sale in the regular course of business.

### When do I owe use tax?

Typically, you will owe use tax on property

- Purchased for resale, but withdrawn from inventory and used for another purpose
- Purchased for use from an out-of state retailer who does not collect California tax

### Examples

- You buy office supplies over the Internet from an out-of-state vendor who does not collect California tax. Since you will use the supplies in your business, you owe use tax on their purchase price.
- You operate a grocery store and purchase soda for resale without payment of California sales tax. However, instead of selling the soda, you give five cases to employees for the summer picnic. Since you used the soda instead of reselling it, you owe California use tax on the cost of the soda. Please note: If you gave employees food items for the picnic (for example, hot dogs, buns and chips), you would not owe use tax because you are consuming exempt food items.

You should report your use tax liability by reporting the purchase price on line 2 of your tax return "Purchases Subject to Use Tax."

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www.boe.ca.gov



*Note:* In some instances donations to certain charitable organizations are not subject to tax. For more information on these types of donations, contact our Information Center.

► For more information, please order publication 110, *California Use Tax Basics*, or publication 112, *Purchases from Out-of-State Vendors*.

## 2. Short on Time? File Online!



In a world of e-business, e-government, and e-mail, it is only natural to have e-filing. E-filing offers a quick and easy way to file sales and use tax returns *and* to make tax payments online.

### Who can e-file?

You can e-file if you

- Conduct business at a single location and
- File either form BOE-401-EZ or form BOE-401-A (and use only Schedule A)

You cannot e-file if you are required to pay taxes by electronic funds transfer.

### Where can I get more information?

For an overview of the program, go to [www.boe.ca.gov](http://www.boe.ca.gov) and click on "electronic services." You can obtain general information and read answers to frequently asked questions.

### How does it work?

To e-file your return and payment, you must select a service provider listed on our website. Your service provider will give you directions on how to enroll and how to file and pay electronically. Please be aware that the service provider may charge you a fee. This fee is not revenue to the Board.

Service providers have been authorized by the Board to receive return and payment information from taxpayers and to transmit the information real-time to the Board.

### What do I do if there is a technical problem?

If you encounter technical difficulties with filing electronically, you must still file a paper return and make your payment timely. To avoid penalty and interest charges, your paper return envelope must be postmarked by the tax due date.

## 3. Help For Small Businesses

Do you feel like you are under an avalanche of acronyms? BOE, EDD, FTB, IRS — all those agencies and all those responsibilities! Well, there is hope. All you need to do is sign up for a small-business fair in your area to get information on a variety of local, state, and federal tax reporting requirements.

### Classes, handouts, and one-on-one help

A number of seminars are offered at each fair. The topics vary, but items typically covered are reporting requirements for sales taxes, payroll taxes, and income taxes; reporting for Social Security; property taxes; bad check enforcement; INS requirements and problem resolution with the Taxpayers' Rights Advocate. In addition, representatives from the Board of Equalization, FTB, EDD, IRS and many other agencies are on hand to help answer your individual questions and provide free handout references.

### See you there? Make a reservation.

Seminars will be held this fall at the locations listed below. If you would like to attend, please contact the specific Board office to confirm the date, location, topics and to reserve your spot.

#### San Gabriel Valley

September 22 • Radisson Hotel  
West Covina Office (626) 480-8226

#### Orange County

September 28 • Cal State University Fullerton  
Laguna Hills Office (949) 461-5732

#### Fresno

October 11 • Radisson Conference Center  
Fresno Office (559) 248-4200

#### Van Nuys

October 17 • Airtel Plaza Hotel  
Van Nuys Office (818) 901-5690

#### Central Valley

October 17 • Radisson Hotel  
Stockton Office (209) 469-7484

#### Ventura

October 18 • Radisson Hotel  
Ventura Office (805) 677-2771



#### Chico

October 23 • Holiday Inn  
Sacramento Office (916) 227-1882

#### Bakersfield

November 7 • Holiday Inn Select  
Bakersfield Office (661) 334-3909

For more information, please contact your local Board office or our Information Center. You can also check us out on the Internet at [www.boe.ca.gov/tpsched.htm](http://www.boe.ca.gov/tpsched.htm). For other education programs go to [www.boe.ca.gov/tpeduc.htm](http://www.boe.ca.gov/tpeduc.htm).

## 4. Recently Revised Regulations May Affect Your Business

The following sales and use tax regulations have been revised since July 2000. A notation follows the summary if we have already written a *Tax Information Bulletin* article on the subject. If you have any questions about the revisions, please contact our Information Center.

Copies of the regulations and past *Bulletin* articles can be found on our website, [www.boe.ca.gov](http://www.boe.ca.gov).

- **1506, *Miscellaneous Service Enterprises*** – revision explains the application of tax to architectural services.
- **1525.2, *Manufacturing Equipment*** – revised the sections affected by the January 1, 2001, ¼ percent state sales and use tax decrease. As a result of the state tax decrease, the manufacturer's exemption decreased from 5 percent to 4.75 percent.
- **1532, *Teleproduction or Other Postproduction Service Equipment*** – revised the sections affected by the January 1, 2001, ¼ percent state sales and use tax decrease. As a result of the state tax decrease, the teleproduction exemption decreased from 5 percent to 4.75 percent.
- **1584, *Membership Fees*** – increased the nominal amount of membership fees from \$40 to \$45. "Nominal" membership fees that meet certain requirements are not included in the retailer's gross receipts.
- **1591, *Medicines and Medical Devices*** – explains that certain feeding therapies and dental implant systems, including dental

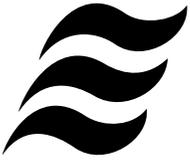
bone screws and abutments, may be considered medicines.

- **1595, *Occasional Sales – Sale of a Business – Business Reorganization*** – explains how tax applies to a series of occasional sales (see March 2001 issue).
- **1620, *Interstate and Foreign Commerce*** – clarifies the application of tax to aircraft purchased outside of California for use in this state (see March 2001 issue).
- **1655, *Returns, Defects and Replacements*** – clarifies the application of tax to repair warranties when the customer pays a deductible (see article 12) and to Lemon Law transactions (see article 11).
- **1661, *Leases of Mobile Transportation Equipment*** – includes houseboats in the definition of "mobile transportation equipment."
- **1702.6, *Suspended Corporations*** – explains when a corporate officer or shareholder of a suspended, closely held corporation is personally liable for sales or use tax liabilities incurred during the suspension period (see March 2001 issue).
- **1706, *Drop Shipments*** – clarifies the application of tax to drop shipment transactions (see March 2001 issue).

## 5. Sales and Purchases by Optometrists and Dispensing Opticians

If you are an optometrist or dispensing optician, you are a consumer for tax purposes when you purchase the items described below. As a consumer, rather than a retailer, you must pay tax on your purchases of such materials.

- **Optometrists.** You are a consumer of ophthalmic materials, including eyeglasses, frames, and lenses used in the performance of your professional services in the diagnosis, treatment or correction of condition of the human eye.
- **Dispensing opticians.** You are a consumer of ophthalmic materials, including eyeglasses, frames, and lenses when you dispense those items pursuant to a prescription prepared by an optometrist.



When you sell ophthalmic materials pursuant to a prescription, you should pay tax on your purchase of those items. If you purchase them from an out-of-state supplier or under a resale certificate, you are required to report tax on your cost (on line 2 of your return, "Purchases Subject to Use Tax").

### **Sales of plano lenses and noncorrective sunglasses**

How tax applies to sales of plano lenses and noncorrective sunglasses depends on whether you sell those materials pursuant to a prescription. If you sell them pursuant to a prescription, you are the consumer of the lenses and glasses and will need to pay tax on your purchase of those items. If you sell them as nonprescribed items, you are a retailer of those items and must report tax on their retail selling price.

### **Are ophthalmic materials considered exempt "prescription medicine"?**

No. Ophthalmic materials do not qualify as exempt prescription medicine. Consequently, optometrists and dispensing opticians are either consumers (with tax due on their cost) or retailers (with tax due on the selling price). The distinction is whether the ophthalmic materials are sold on a prescription or nonprescription basis.

## **6. Are Sales of Distilled Water Taxable?**

They say that distilled waters run deep. But did you know they can also be taxable?

Sales tax does not apply to sales of noncarbonated, noneffervescent bottled *drinking* water because the water is considered a food product. However, bottled distilled water is often used for purposes other than drinking — for example, filling steam irons and car batteries. When bottled water is not sold for human consumption, the sale of the water is taxable.

### **Read the Label**

To determine whether your sales of bottled distilled water are subject to tax, you must examine the product's label. If the label includes a reference that the distilled water is intended for human consumption (drinking), the sale of that bottled water qualifies for exemption as a food product. If the distilled water label does not reference intend-

ed use, or is labeled *only* for nonfood uses, the sale of the water is taxable.

## **7. Ask Us for a Receipt!**

### **In-person payments**

We provide a receipt for sales and use tax payments made in-person at one of our field offices or made outside our offices to one of our field representatives. The receipt identifies how the payment was applied and is your permanent record of payment. When you accept the receipt, inspect it for accuracy. If you have a question, ask for assistance. If you do not receive a receipt, ask that one be provided.

### **Payments by mail**

For payments mailed to the BOE, a receipt will not be sent unless specifically requested. Your cancelled check is your receipt.

## **8. Illegal Cigarettes and Tobacco Products Can Be Confiscated**

Retailers who purchase cigarettes or tobacco products from other than licensed wholesalers and distributors should be aware that they are in violation of the law and the product is subject to seizure by the Board of Equalization.

The Board's Investigations Division actively investigates and makes seizures of counterfeit stamped cigarettes and imports of domestic labeled cigarettes or export type cigarettes stamped in violation of the law.

A retailer's best defense against dealing in products subject to seizure is to purchase cigarettes only from a licensed cigarette wholesaler or distributor and to obtain a purchase receipt that contains the proper information. Under Regulation 4092, *Receipts for Tax Paid to Distributors*, every cigarette distributor is required to give the retailer a receipt. A proper sales invoice, together with evidence of payment, constitutes a valid receipt.

If you have any questions or concerns over the product you are purchasing, please contact the Board of Equalization at (916) 324-0105, or write to us at Board of Equalization, Investigations Division, 450 N St. MIC: 42, Sacramento, CA 95814.



## 9. How Does Tax Apply to Core Charges for Vehicle Repair Parts?

Putting the “parts” together in figuring out taxes can be just as challenging as putting the parts together on a vehicle. The parts must fit right to get the right results.

For example, a common problem area is how to apply tax when there is a “core” charge.

Core charges are trade-in allowances included in the selling price of a part. They are designed to encourage the return of old parts that can be re-manufactured. Auto parts sellers often include a core charge when they sell parts such as batteries, water pumps, brake shoes, and alternators.

### *Example*

A seller sells a battery for \$54, which includes a \$7 core charge. If the buyer trades in his or her old battery, the seller will give the buyer a \$7 credit toward the purchase.

### **How tax applies**

How you calculate the taxable selling price of the part will depend on whether you are selling a new or used part, or a reconditioned or rebuilt part.

### *New or used parts*

You are liable for tax on the selling price of the new or used part, *including* the core charge. Tax applies to the core charge because the allowance for the trade-in is considered part of your “payment” for the sale.

### *Example*

Selling price of new battery (includes a \$7 core charge)	\$54.00
Tax (\$54 x 7%)	3.78
Trade-in allowance	- 7.00
Total	\$50.78

Some sellers separately invoice the trade-in allowance for an old battery as a “core charge.” Even though the trade-in is separately invoiced, tax must still be calculated on the selling price *before* the trade-in.

### *Reconditioned or rebuilt parts*

On sales of reconditioned or rebuilt parts, tax applies to the “exchange price.” The exchange price

is the total selling price of the part, including any core charge, less any credit you give the customer for turning in a worn part.

You should not tax the core charge credit whether you give it to the customer at the time of the sale or at some later point. If you refund a core charge to your customer after the original sale, you must also be sure to refund any tax you collected on the charge. Any tax you do not refund must be paid to the Board.

### *Example*

Rebuilt alternator (including \$9 core charge)	\$120.00
Core charge credit	- 9.00
Taxable selling price	111.00
Tax (\$111.00 x 7%)	7.77
Total	\$118.77

Tax does not apply to the core charge because you are selling a reconditioned or rebuilt part.

## 10. Tire Recycling Fee Now Applies to New Tires on New or Used Vehicles That Are Leased, Rented, or Sold

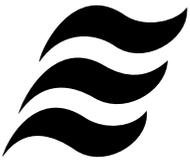
As the result of the passage of Senate Bill 876 (ch. 838, Stats. 2000), the Tire Recycling Fee has been expanded to include additional feepayers.

Prior to the passage of the bill, the fee applied only to new tires that were sold separately and were sold for use with on-road motor vehicles, motorized equipment, construction equipment, or farm equipment. With the passage of AB 876, effective January 1, 2001, the fee now also applies to new tires on new and used vehicles when those vehicles are leased, rented, or sold. Specifically, the fee applies to new tires provided with

- A new or used motor vehicle (including the spare tire),
- New or used construction equipment, or
- New or used farm equipment.

When a vehicle is sold with new tires, the fee is due upon the retail sale of that vehicle. When a vehicle is leased or rented the fee is due on the first rental or lease of the vehicle.

(see over)



### **Are you registered?**

We have tried to contact businesses that we believe should be registered to pay the fee. If you have not been contacted and sell new tires, as described above, please call us immediately to register. Call the Excise Taxes Division at 1-800-400-7115 or 916-327-4208.

## **11. The California Lemon Law and Sales Tax Refunds**

*The following article reflects recent amendments to Regulation 1655, Returns, Defects, and Replacements. To obtain a copy, call 1-800-400-7115.*

Under specific conditions, a manufacturer may claim a refund of sales tax for vehicles returned to them under California's Lemon Law.

Under the Lemon Law (Civil Code section 1793.2), a manufacturer is required to provide restitution or a replacement to the buyer of a new vehicle when the vehicle is a "lemon." To qualify as a "lemon," a vehicle must have a defect that cannot be repaired after a reasonable number of attempts. In addition, the manufacturer must note on the title that the vehicle was a Lemon Law buyback and place a decal in the car with the same information.

A manufacturer that has met all the conditions of the Lemon Law may file a claim for refund with the Board for any tax included in the amount of restitution paid to the buyer. If the buyer is instead provided with a replacement vehicle, the manufacturer is considered replacing the vehicle under the terms of a mandatory warranty. No additional tax is due unless the buyer is required to pay an additional amount to receive the replacement vehicle (tax is due on the amount of the additional payment). If in addition to a replacement vehicle, the buyer is also refunded money as restitution, the manufacturer may file a claim for refund with the Board for any tax included in the amount of restitution (money) paid to the buyer.

A manufacturer may allow an authorized dealer to act as its agent for purposes of determining the amount of restitution that is due or to provide a replacement vehicle.

*Please note:* A manufacturer may not file a claim for refund if the buyer of the defective vehicle is allowed a credit on the purchase of a new vehicle rather than restitution or a replacement vehicle as required by the Lemon Law.

## **12. How To Calculate Tax When Your Vehicle Warranty Includes a Deductible**

*The examples in the following article assume a 7 percent sales and use tax rate, which is the state-wide base rate. The rate in some areas of the state is higher. — Editor*

Regulation 1655, *Returns, Defects and Replacements*, was recently revised to clarify how tax applies to warranties that include a customer deductible. Although the regulation applies to warranties in general, deductibles are common with both mandatory and optional vehicle warranty contracts. The following information explains the application of tax to typical vehicle warranty contracts.

### **Mandatory Warranties**

A warranty is mandatory if the buyer, as a condition of sale, is required to purchase the warranty from the seller. In general, a manufacturer's warranty is a warranty provided by the vehicle manufacturer and is included in the selling price of the vehicle when sold by the dealer. A manufacturer's warranty is considered a mandatory warranty.

#### ***Taxability when there is no deductible under a mandatory warranty***

Tax does not apply to charges for parts used for the repair. Although the repairer will charge the manufacturer for the parts used in the repair, those parts are considered a sale for resale and are not subject to tax under a mandatory warranty. They are considered sold to the customer as part of the original sale of the vehicle.

#### ***Taxability when there is a deductible under a mandatory warranty***

If the customer pays a deductible, tax does apply. The tax amount is measured by the amount of the deductible allocable to the sale of the parts to the customer.



Unless otherwise stated in the warranty contract, when the warranty provides that the customer will pay a deductible towards repairs and services provided under the warranty, the person providing the warranty contract is liable for any tax or tax reimbursement otherwise payable by the customer with respect to that deductible.

*Example 1*

A customer is required to pay a \$50 deductible under a manufacturer's mandatory warranty. The repairer bills \$200 for the repair work (not including tax): \$75 for parts and \$125 for labor. The portion of the deductible subject to tax would be:  $\$75 \div \$200 = 37.50\% \times \$50 \text{ deductible} = \$18.75$ . Tax due on the deductible payment equals \$1.31 ( $\$18.75 \times 7\% \text{ tax rate}$ ).

The total charge for the job would be \$201.31. The repairer would charge \$50 (deductible) to the customer and the balance, \$151.31, to the manufacturer (\$200 parts/labor + \$1.31 sales tax - \$50 deductible).

*Note:* In this example, we have assumed there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property (parts).

**Optional Warranties**

A warranty is optional when the buyer is not required to purchase the warranty from the seller, but may optionally purchase the warranty from the seller or someone of his/her own choosing. Optional vehicle warranties can be offered by both the manufacturer and the dealer.

***Optional warranties offered by the dealer***

If the customer is not obligated to pay a deductible, the dealer (repairer) is considered the end user of the repair parts and owes tax on his or her cost for the parts. (In other words, the repairer is not a seller of the parts and tax does not apply to the transfer of the parts to the customer.)

If the customer is obligated to pay a deductible, the repairer is considered the *end user* of a portion of the parts and a *seller* of the remainder (see Example 1 for an example of how to prorate a portion of the deductible as a seller).

Unless otherwise stated in the warranty contract, when the warranty provides that the customer will pay a deductible towards repairs and services provided under the warranty, the person providing the warranty contract is liable for any tax or tax reimbursement otherwise payable by the customer with respect to that deductible.

***Optional warranties offered by the manufacturer***

The manufacturer is considered the consumer of the repair parts for tax purposes. As a result, tax applies to the retail sale of parts to the manufacturer by the dealer (repairer). The repairer performing the repairs under the optional warranty is considered the retailer of the parts to the manufacturer and is responsible for reporting sales tax on the retail selling price of the parts (cost plus the markup).

*Example 2*

A customer is required to pay a \$50 deductible under a manufacturer's optional warranty. The repairer bills \$200 for the repair work (not including tax): \$75 for parts and \$125 for labor. Under an optional warranty, sales tax would apply to the full charge for parts ( $\$75 \times 7\% \text{ tax rate} = \$5.25 \text{ tax}$ ).

The total charges for the job would be \$205.25 ( $\$200 \text{ parts/labor} + \$5.25 \text{ tax}$ ).

The repairer would charge \$50 (deductible) to the customer and \$155.25 to the manufacturer ( $\$200 \text{ parts/labor} + \$5.25 \text{ sales tax} - \$50 \text{ deductible}$ ).

*Note:* In this example, we have assumed there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property (parts). If the warranty contract does provide that the customer is liable for tax or tax reimbursement on the portion of the deductible related to parts, the repairer must prorate any charges for sales tax reimbursement between the customer and the manufacturer. This calculation can be complicated. Please call our Information Center for assistance.



### 13. New or Revised Reference Material

For copies, call 1-800-400-7115 or visit our website, [www.boe.ca.gov](http://www.boe.ca.gov).

#### Publications

- 56 Offers in Compromise (March 2001)
- 105 District Taxes and Delivered Sales (March 2001)
- 116 Sales and Use Tax Records (March 2001)

#### New Translations: Tax Facts

The following publications are now available in Spanish:

- 100-S Shipping & Delivery Charges
- 101-S Sales Delivered Outside California
- 102-S Sales to the US Government
- 103-S Sales for Resale
- 104-S Sales to Residents of Other Countries
- 105-S District Taxes and Delivered Sales
- 107-S Do You Need a California Seller's Permit?
- 108-S When Is Labor Taxable?

#### Regulations

- 1525.2 Manufacturing Equipment  
January 1, 2001
- 1532 Teleproduction or Other  
Postproduction Service Equipment  
February 13, 2001
- 1584 Membership Fees  
January 1, 2001
- 1591 Medicines and Medical Devices  
April 12, 2001
- 1595 Occasional Sales – Sale of a Business –  
Business Reorganization  
February 4, 2001
- 1620 Interstate and Foreign Commerce  
December 17, 2000
- 1655 Returns, Defects and Replacements  
January 18, 2001
- 1661 Leases of Mobile Transportation  
Equipment  
December 1, 2000
- 1702.6 Suspended Corporations  
October 18, 2000
- 1706 Drop Shipments  
December 28, 2000

### Do You File Tax Returns Once a Year?

If you do, the only *Tax Information Bulletin* you receive is the one that is mailed with your return. If you would like to be added to a mailing list to receive each quarterly issue, you may write to us and ask to be added to mailing list #15. Write to the following address:

Addressing Systems, MIC:12  
Board of Equalization  
PO Box 942879  
Sacramento, CA 94279-0012

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### *For More Information*

#### Information Center

1-800-400-7115

*Telephone devices for the deaf*

1-800-735-2929 (TDD phone)

1-800-735-2922 (voice phone)

#### Internet

[www.boe.ca.gov](http://www.boe.ca.gov)

[www.taxes.ca.gov](http://www.taxes.ca.gov)

#### Seller's Permit Verification

Visit our website, or  
call toll-free, 1-888-225-5263.

#### Taxpayers' Rights Advocate

Call toll-free, 1-888-324-2798.

#### Tax Evasion Hotline

Call toll-free, 1-888-334-3300.

#### Legislative Bills

[www.leginfo.ca.gov](http://www.leginfo.ca.gov)