

# **Audit Manual**

## **Chapter 9**

# **Grocers**

Business Tax and Fee Division

*California Department of  
Tax and Fee Administration*

*This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda. Please contact any California Department of Tax and Fee Administration office if there are concerns regarding any section of this publication.*



**GROCERS**

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**GROCERS****0900.00****INTRODUCTION****0901.00****GENERAL****0901.05**

For purposes of this chapter, a grocer is a retailer whose principal business is the sale of food products and related items. The term includes separate grocery departments in department stores, but does not include delicatessens, country or general merchandise stores, and establishments that handle groceries as a sideline.

A problem often arises in audits of liquor stores with a substantial volume of sales of merchandise normally sold in grocery stores. Whether these qualify as grocery stores will depend on the fundamental nature of the business. Generally, in order to fall within the definition of a grocery store, at least 50% of the total sales should be comprised of exempt food products and taxable grocery sales. See Exhibit 8 for examples of taxable grocery items to determine if the taxpayer meets the definition of a grocer.

**AUDIT PROCEDURES****0901.10**

Due to the diverse nature of the retail grocery industry, auditing procedures must be flexible enough to meet every condition encountered. Procedures appropriate for use in auditing the corner grocery store may not be the same as those used in auditing chain store operations.

The instructions and suggestions which follow are not intended to be rigid and inflexible, but are designed as guidelines which can be followed to help simplify and attain more uniformity in grocery store auditing. Reasons for major deviations from procedures outlined in this chapter should be fully explained in audit working papers.

Many of the provisions of Regulation 1602.5, Reporting Methods for Grocers, have major significance only for the larger grocers. In applying the regulation to audit situations, primary consideration should be given to materiality. The taxpayer should always be advised of correct reporting procedures, whether the purchase-ratio, markup or any other method of reporting is used. If errors are deemed immaterial and no adjustment is made, auditors must inform taxpayers of the proper reporting procedures with appropriate audit comments referencing information and/or instruction given to the taxpayer.

The audit method should conform to the taxpayer's method of reporting insofar as it is practical and possible. The auditor is justified in using an audit method different from the method of reporting used by the taxpayer if:

- (a) The taxpayer's records are fragmentary and incomplete, making proper verification impossible.
- (b) Use of the taxpayer's method produces an unrealistic or illogical result based on preliminary testing of the book markup and/or taxable markup.

If the taxpayer has used more than one reporting method during the audit period, the auditor should use the method used by the taxpayer for each reporting period unless it can be shown that total sales are not properly recorded.

**TOTAL SALES** **0902.00****GENERAL** **0902.05**

Chapter 4 of the Audit Manual outlines various procedures for verifying total sales in general. Much of this material is applicable to audits of grocers.

**VERIFICATION OF TOTAL SALES** **0902.10**

The degree of verification of total sales will depend to some extent on the reporting method used by the taxpayer and the audit method used by the auditor.

**VERIFICATION OF TOTAL SALES — PURCHASE-RATIO METHOD** **0902.15**

When the purchase-ratio method is used to verify the sales of food products, it is essential that total sales first be established as being accurate. *If total sales are impeached, the mark-up-method should be used for audit purposes.*

**VERIFICATION OF TOTAL SALES — MARKUP METHOD** **0902.20**

Where it is necessary to mark up purchases to determine taxable sales, the verification of total sales is not essential. In some instances, however, it may be desirable to verify total sales as further support for recommended determinations or refunds.

**USING INCOME TAX RETURNS IN VERIFICATION** **0902.25**

Income tax returns may be of value in the verification process. However, they cannot be expected to be more accurate than the records from which they were prepared. They are sometimes useful as supplemental verification of purchases, cost of sales or sales and are a possible source of information regarding acquisition and disposition of capital assets.

Differences between reported sales per income tax returns and sales tax returns do not necessarily mean the latter have been prepared inaccurately. The procedures set forth in Chapter 4 of the Audit Manual should be followed where these differences are present.

**BARTER SYSTEM** **0902.30**

It is not uncommon for grocers operating in rural areas to purchase farm products from their customers. In many instances, the farmer trades his/her products for staple groceries and supplies. The auditor should verify that the value of the merchandise so traded is included in sales and purchases.

**SALES OF CAPITAL ASSETS** **0902.35**

Taxable sales of equipment generally can be verified by examination of general ledger accounts, cash receipts records or income tax returns.

Generally, tax applies to the sales of tangible personal property held or used in the course of an activity requiring the holding of a seller's permit. Sales of fixtures and equipment used in a grocery store are subject to tax regardless of the fact that certain fixtures and equipment were used exclusively in selling food products. For example, a sale of fixtures and equipment used exclusively in the meat department operated under the same ownership as the grocery store in which it is located is subject to tax because the property was used in a business requiring a seller's permit. (See Regulation 1595.)

Sales of fixtures and equipment used exclusively in a business for which a seller's permit is not required may be exempt as occasional sales. For example, the sale of a refrigeration unit used in a meat market making no sales of dog food, bones, or any taxable items would be exempt unless such sales qualify the taxpayer as a retailer of equipment.

**COUPON REDEMPTION****0902.40**

There are many types of coupon redemption plans used by grocers. Several of the most common types of coupon redemption plans are discussed below.

**Manufacturer's Coupons**

Grocers often redeem coupons for manufacturer's products. The manufacturer may handle the distribution of the coupons or may authorize the grocer to publish a coupon in a newspaper or handbill advertisement. The coupon offers the bearer a specified amount off the regular price of the manufacturer's product, and the manufacturer agrees to pay the retailer for each coupon redeemed plus an amount for handling.

Amounts paid by a manufacturer to a retailer for coupons redeemed by the retailer, exclusive of amounts paid for handling, constitute gross receipts of the retailer. If the amount paid by the manufacturer, exclusive of handling, is less than the face value of the coupon, only the amount paid is includable in the retailer's gross receipts since there is no consideration for the difference.

Many stores use coupon redemption centers that make a charge for their services. If the service charge made by the coupon redemption center is greater than the handling charge permitted by the manufacturer, the excess charge may not be deducted from gross receipts. Regardless of the reporting method used by the grocer, the auditor should verify that amounts received or accrued by the grocer for the redemption of coupons are treated as gross receipts from the sale of the product and not as a reduction of purchases.

**Retailers' Coupons**

Many grocers publish or send out free coupons that are redeemable for merchandise at their store and are not reimbursed in any manner by a manufacturer. The face value of the coupon is a cash discount. Consequently, tax applies to the selling price after the discount.

Cash discounts for taxable products are deductible from reported taxable sales if the full amount of the sale, without deduction for the discount, is included in the grocer's reported total sales.

**Double-Discount Coupons**

Double-discount coupons redeemed consisting of a combined manufacturer's coupon and the retailer's own store discount must have sales tax based on the regular selling price of the taxable merchandise after deducting only the cash value or face value of the retailer's own discount coupon.

**Grocery Store Discount Club Cards**

Many major grocery store chains use "discount club cards." Discount club cards provide convenience to consumers by relieving them from having to clip and carry paper coupons, but entitle the cardholder to discounts that are similar to those that can be obtained by using paper coupons. The reduction of the selling price of taxable merchandise through the use of discount cards is considered to be a cash discount. When a consumer uses a discount card, the amount of the discount is not subject to tax, regardless of the source of the discount, i.e., the manufacturer, distributor, or retailer.

**CALIFORNIA REDEMPTION VALUE (CRV)****0902.50**

Regulation 1589(a) specifically excludes redemption or recycling values of beverage containers from the definition of the term “deposit.” As such, CRV fees are included in the gross receipts of the seller of the container. Beginning January 1, 2000, the list of beverages subject to CRV was expanded to include nontaxable beverages such as noncarbonated fruit drinks and bottled water. If the beverage is considered a nontaxable food product, the CRV charges related to that product are also nontaxable. Tax still applies to CRV charges related to taxable beverages.

All retailers with sales and storage areas totaling more than 4,000 square feet are required to separately state the redemption value in all advertising and on the shelf. The fact that these fees are separately stated (both to the retailer and to their customers) should not affect the method of computing the markup in an audit. The CRV amounts are a cost to the retailer and are a part of the taxable gross receipts. Auditors should ensure CRV amounts are properly accounted for when using markup methods to establish sales.

**LOTTERY****0902.55**

Lottery receipts are not part of a retailer’s gross receipts for sales and use tax purposes and should not be included in the taxpayer’s reported sales. Auditors should verify that lottery receipts are not included in reported sales. If lottery sales were included in reported sales, auditors should segregate the lottery amount to determine food sales.

**MISCELLANEOUS OTHER SALES****0902.60****Film Processing**

Tax generally applies to all charges involved in processing film, including charges for coloring and tinting new pictures. However, itemized charges for developing negatives from a customer’s exposed film are generally not taxable. This is to be distinguished from charges for developing by the reverse process method, which is subject to tax (the reverse process method consists of developing the film to a negative and reversing it into a positive, usually in the form of a slide or a home movie film).

**Rentals**

Some grocery stores rent videotapes, video equipment, and carpet cleaners. Rentals of videotapes or videodiscs for private noncommercial use are subject to tax. Tax applies to such rentals even though tax was paid on the cost of the item either to the grocer’s vendor or directly to the Board of Equalization (BOE). If videotapes and video equipment are rented for a lump-sum charge, tax applies either to the entire charge or to a portion. If the video equipment was acquired tax-paid, there would be no tax on the portion of the charge related to the equipment. Taxable rental receipts would be measured by the ratio of the fair rental value of the videotapes and video equipment as applied to the lump-sum rental charge. If the video equipment was acquired without tax, the entire charge for the videotapes and video equipment is subject to tax.

Tax may or may not apply to the rental receipts for carpet cleaner rentals depending on whether tax was paid on the cost of the equipment. Auditors should be aware of such types of rentals to ensure the correct amount of tax is reported. Additionally, if charges for the soap and cleanser supplies are included into the rental price of tax-paid equipment, the grocer is considered the consumer of these supply items. (See Regulation 1660.)

**Photocopy Machines**

Some grocery stores have photocopiers for customers to use. Tax applies to sales of photocopies. (See Regulation 1528.)



**PURCHASES SUBJECT TO USE TAX 0903.00****TYPES 0903.05**

The average grocer's liability for purchases subject to use tax is generally limited to:

- (a) Merchandise withdrawn from stock and converted to own use.
- (b) Capital and expense items purchased under a resale certificate or from an out-of-state retailer.

**SELF-CONSUMED MERCHANDISE IN GROCERY AUDITS 0903.10**

Most grocery stores have self-consumption of taxable merchandise. Some of the more common withdrawals and uses are:

- Cleaning supplies (paper towels, soaps, sponges, etc.)
- Other supplies (toilet paper, aspirin, etc.)
- Taxable items consumed by the owner (sodas, alcohol, cigarettes, laundry soap, etc.)
- Taxable items given to friends, associates or employees

Self-consumption should be discussed at the beginning of the audit and amounts determined. Auditors should be aware that some taxpayers might be reluctant to provide information regarding self-consumption, since they may believe this would increase their tax liability. Auditors should clearly explain to these taxpayers that self-consumption results in tax being due only on the cost of items, rather than the selling price.

Grocers often do not maintain records of self-consumption. Therefore, auditors should, with the aid of the taxpayer, estimate the amount of self-consumption as realistically as possible. To support the amount of self-consumed merchandise, the auditor should include a detailed analysis of the consumed merchandise. This includes a breakdown by category (e.g., beer/wine, liquor, soda, cigarettes, and other taxable merchandise) of the volume consumed by the owners and family members, employees, and merchandise given away. Each category should be converted to cost to arrive at the total self-consumption in dollars and then translated into a percentage of total taxable purchases.

*Use tax should be assessed on any material amounts of self-consumption not reported.*

Additionally, the recorded cost of goods sold should be reduced by the cost of self-consumed merchandise to accurately mark-up purchases and verify sales. (See Exhibit 5.) If a recommended self-consumption allowance is greater than 3% of total taxable purchases, auditors must provide justification and explanation of the allowance in the audit working paper comments.

**PROCEDURE WHERE WITHDRAWALS OF MERCHANDISE HAVE NOT BEEN REPORTED 0903.15****A. Where Purchase Ratio Method Is Used**

Apply the taxable purchase ratio to total amount of merchandise withdrawn by the taxpayer. The amount so computed will be scheduled in the audit working papers. When using this procedure, neither purchases nor total sales need be disturbed.

**B. Where The Purchase Markup Method Is Used**

Estimated taxable withdrawals of merchandise should be scheduled at cost in the audit working papers. The amount scheduled should then be deducted from taxable purchases and a weighted markup applied to the remainder of taxable purchases.

**PROCEDURE WHERE MERCHANDISE  
WITHDRAWALS HAVE BEEN REPORTED****0903.20****A. Where Included On Line 1**

Where both the taxable and nontaxable items have been included at cost, no adjustment need be made when the purchase-ratio-method is used. If taxable items only have been included, they should be deleted from Line 1 before applying the purchase ratio. The amount deleted should then be scheduled in the audit working papers.

**B. Where Included On Line 2**

When the cost of taxable items only has been reported, no further adjustment need be made. If, however, nontaxable items have been included, or the merchandise has been priced at retail, a credit should be allowed.

**CAPITAL EXPENDITURES****0903.25**

General ledger accounts, purchase invoices, and depreciation schedules should be examined to determine if any capital equipment has been acquired ex-tax during the audit period. Observation of the premises may be helpful in determining any acquisitions of new equipment.

**PURCHASES SUBJECT TO USE TAX****0903.30**

The average grocer makes few direct purchases subject to use tax. However, a grocer may purchase expense items ex-tax from his/her regular wholesale sources. When auditing grocers who are located near cities in bordering states, the auditor should be on the alert for purchases of supplies and equipment from out-of-state retailers.

**AUDIT OF CLAIMED DEDUCTIONS 0904.00****GENERAL 0904.05**

Chapter 4 of the Audit Manual outlines general procedures to be used in verifying deductions. Only those deductions particular to grocery stores will be discussed in this chapter.

**SALES FOR RESALE 0904.10**

After having verified the accuracy of sales for resale, the cost of resales as well as the total sales for resale should be eliminated from purchases and total sales, respectively, for purchase-ratio purposes. This procedure is necessary as seldom, if ever, do sales for resale have the same taxable ratio as do sales to consumers.

**SALES OF FOOD PRODUCTS FOR HUMAN CONSUMPTION 0904.15**

Revenue and Taxation Code (RTC) section 6359 provides an exemption from sales and use taxes for sales of food products for human consumption under certain circumstances. Regulation 1602, *Food Products*, interprets and applies RTC section 6359.

RTC section 6359, subdivision (c) provides, “Food products” do not include “medicines and preparations in liquid, powdered, granular, table, capsule, lozenge, and pill form sold as dietary supplements or adjuncts.” Even if a product would otherwise qualify as a food product for purposes of the exemption described in RTC section 6359, it does not qualify as a food product if it is a medicine or if it is sold as a supplement or adjunct. A product is either a food product, medicine, or a dietary supplement or adjunct; these classifications are mutually exclusive.

Groccers may use any method they choose to compute the amount of exempt sales of food products for human consumption claimed on their sales tax returns. They must, of course, maintain adequate records to support the amount so claimed. Audit procedures for verifying this deduction are explained in subsequent sections. For markup methods for businesses selling a minimal amount of exempt food items, see AM section 0407.12.

One of the first steps in verifying the claimed exempt food deduction is to determine if the taxpayer correctly classified its claimed exempt sales of food products. Listed below are some common food products sold by groccers and the tax application (see Regulations 1602 and 1603, *Taxable Sales of Food Products*, for additional information).

**NOTE:** Sales of taxable items (such as soda) purchased with CalFresh benefits (see AM section 0904.30) may be included in claimed exempt sales of food products by the taxpayer if they do not separately claim those sales as exempt sales to the U.S. Government.

**Taxable Food Products**

Sales of food products for human consumption are generally exempt from tax. However, if an item does not qualify as a food product defined in Regulation 1602 or if it is not sold for human consumption it is generally subject to tax. Examples of items that do not qualify as food products are:

- Ice
- Over-the-counter medicines
- Alcoholic beverages
- Coloring extracts
- Tobacco products
- Dietary supplements, as specified in Regulation 1602 (a)(4)
- \*Carbonated beverages, including semi-frozen beverages containing carbonation (i.e., “slushies”)

\*Carbonated products that qualify as 100 percent natural fruit juice are not subject to tax. If the fruit juice includes a preservative, such as benzoate or any other additive, it is not considered a natural fruit juice and is subject to tax.

Also, a food product sold for consumption by a dog, cat, bird and other domestic pet or for use as fish bait or use by a zoo to feed the animals is subject to tax because it is not sold for human consumption.

**Food Products – Medicinal Claims**

As provided in part in Regulation 1602, subdivision (a)(3), food products do not include medicines. “Medicine” in Regulation 1602, has the same meaning as defined in Regulation 1591, *Medicines and Medical Devices*. Regulation 1591, specifically subdivisions (a)(9) and (b)(1) set forth the relevant tests to determine if a product is a medicine. If the product is considered a medicine then the food product exemption is inapplicable.

First, 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, then it is a medicine under Regulation 1591, subdivision (a)(9)(A) and is not a food product.

Second, if the product is “commonly recognized” as a substance or preparation for use in the mitigation, treatment, or prevention of disease, then it is a medicine under Regulation 1591, subdivision (a)(9)(B). “Commonly recognized” as a medicine means general acceptance indicated by either:

- The greater weight of opinion in the medical community, as reflected, for example, by referenced medical journals or similarly authoritative scientific publications or pronouncements from authoritative regulatory institutions; or
- Constitutional, statutory, or controlling case law authorities establishing that the substance or preparation in question is a medicine as a matter of law.

For purposes of the food products exemption, a product’s labeling that it is a medicine is not determinative and will not automatically disqualify it from the food products exemption. If a product does not meet the definition of medicine, as provided in Regulation 1591, it may still be considered a food product for human consumption. This is true even if medicinal claims are made on the product’s label or product brochures.

**Vitamin Enhanced Water**

Noncarbonated, vitamin enhanced water beverages and sport drinks are generally considered food products. Sales of these products by grocery stores or other retailers on a to-go basis are generally not subject to tax. Noncarbonated bottled water is specifically considered a food item. The compounding of nutritional elements, such as vitamins, in an item traditionally accepted as food, such as vitamin enriched water, does not alone render the product taxable nor does including the word “vitamin” in a food product name, description, or product advertising.

**Food or Dietary Supplements or Adjuncts (Health Foods)**

Sales tax generally applies to preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts. If an item is sold in one of these specified forms, then tax applies if any of the following conditions are met:

- If an item is described on its label or package as a food supplement, food adjunct, dietary supplement, or dietary adjunct, its sale is subject to tax.
- If an item is prescribed or designed to remedy specific dietary deficiencies or to increase or decrease generally one or more areas of human nutrition dealing with vitamins, protein, minerals or calories, its sale is subject to tax.
- If an item is in one of the specified forms, it may be taxable if it is generally recognized as a dietary supplement, even though it is not described as such on its package and does not emphasize its vitamin, protein, mineral, or calorie content. Examples include cod liver oil, wheat germ oil, and amino acid products.

In addition, items that would otherwise be considered supplements which are complete dietary foods providing the user in the recommended daily dosage with substantial amounts of vitamins, proteins, minerals and caloric intake will qualify as food products exempt from tax. In evaluating whether a product meets the daily food requirement, a multiple daily serving recommendations on the label should be taken into consideration.

**Dietary Supplements or Adjunct Products Provided by Physicians**

Generally, if a supplement does not qualify as a complete dietary food under Regulation 1602, it is subject to tax. However, in limited circumstances, dietary supplements can be considered “medicines.” The sale of supplements will not be taxable if a physician prescribes the supplement to his or her own patient as part of a medically supervised weight loss program to treat obesity.

**Herbal Products**

Herbs sold in cut leaf form, including tea, are not considered a supplement or adjunct regardless of what is written on the label because it is not sold in liquid, powdered, granular, table, capsule, lozenge, and pill form. Only a dried herb that is ground or crushed into the form of fine particles should be considered a powder. For such an herb to be considered to be sold as a supplement or adjunct, it must be either:

- Described on its package or label as a food supplement, food adjunct, dietary supplement, or dietary adjunct, or
- Prescribed or designed to meet specific dietary deficiencies or increase or decrease vitamins, proteins, minerals, and/or caloric intake.

As a general matter, herbal products such as teas are not prescribed or designed to meet specific dietary deficiencies or to increase or decrease the listed areas of human nutrition. Therefore, when an herb product is not described on its package or label as a food supplement, food adjunct, dietary supplement, or dietary adjunct, the herb product will typically be considered a food product the sale of which is exempt from tax.

**Hot Prepared Food**

Sales of hot prepared food products are subject to tax regardless of whether sold for consumption on the premises or sold “to go.”

A food product is considered a hot prepared food product if it is heated to a temperature above room temperature. Hot food is considered a hot prepared food even if it has cooled by the time of sale since it was intended to be sold as a hot food. Examples of hot prepared food sold by grocers include hot chicken, hot spareribs, hot soups, and hot popcorn. However, tax does not apply to sales of hot bakery items and hot beverages (e.g., coffee, tea, hot chocolate, cider, etc.) if they are sold “to go” and for a separate price.

Sales of combination meals (soup and sandwich; or sandwich, chips and drink) for a single price are taxable sales if the meal contains any of the following items:

- A hot prepared food (such as a hot sandwich)
- A hot beverage (such as hot coffee or chocolate)

Examples of such types of taxable sales include a combination of a hot pastrami sandwich and salad sold for a single price, and a doughnut and hot coffee sold for a single price.

**Food Service Operations**

Some grocers may have snack bars, soda fountains, cafeterias or similar operations. Sales of sandwiches, ice cream, or other food product are subject to tax if sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware that grocers provide. For example, if a grocer provides tables and chairs for customer in the store’s delicatessen section, tax applies to the food sold for consumption at the tables and chairs. Tax also applies to sales of hot prepared food as discussed above. However, tax does not apply to sales of cold food products sold “to go.” If a grocer sells a combination meal that includes a cold food item and a carbonated beverage “to go,” only the sale of the carbonated beverage is taxable.

**COMBINATION FOOD PACKAGES****0904.20**

Sales of a combination package that includes exempt food products and nonfood products are considered exempt sales of food if:

- The retail value of the food contents is at least 90 percent of the retail value of the total package contents, and
- The retail value of the package container is 50 percent or less of the retail value of the entire package.

Sales of combination packages that do not meet both of the conditions above are subject to tax based on the selling price of the entire package less the value of the exempt food.

**Example 1**

A grocer sells a gift basket for \$60 which includes the following components:

Fruit, cheese, crackers (exempt food products)	\$45.00
Small cheese knife (nonfood product)	<u>5.00</u>
Total value of contents	\$50.00
Basket	<u>10.00</u>
Total price of combination package	\$60.00

The \$60 package is considered an exempt sale of food products because it meets both conditions listed above. The value of the food items, \$45, is at least 90 percent of the \$50 total value of the contents. And, the value of the container (the basket), \$10, is less than 50 percent of the retail value of the entire package.

**Example 2**

A grocer sells a party tray for \$30 which includes the following:

Meat and cheese (exempt food products)	\$22.00
Serving utensil (nonfood product)	<u>5.00</u>
Total value of contents	\$27.00
Tray	<u>3.00</u>
Total value of combination package	\$30.00

In this example, the retail value of the food products is below 90 percent of the retail value of the total package contents ( $\$22/\$27 = 81\%$ ). Consequently, tax applies to the selling price of the package less the retail value of the exempt food products (that is, tax applies to the retail value of the tray and serving utensil).

To claim an exemption for the food products in the combination package, the taxpayers' records must separately state the value of the food and nonfood items, and those values should be separated on the invoice or receipt.

**Non-Edible Cake Decorations**

If a cake or other bakery good is sold for a single price that includes non-edible decorations, the tax application depends upon the value of the non-edible merchandise versus the value of the cake or bakery good. If more than 50 percent of the total retail value of the cake or bakery good represents the value of non-edible decorations, a segregation must be made and the tax is measure by the retail selling price of such non-edible decorations. Separately stated charges for non-edible decorations are subject to tax.

**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, the following example illustrates the use of the Purchase-Ratio 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 adjustment (7.50% of Item a)	3,000
(c) Adjusted taxable grocery purchases (Item a + Item b)	43,000
(d) Audited exempt food product purchases	130,000
(e) Total grocery purchases including sales tax (Item c + Item d)	173,000
(f) Exempt food purchases ratio (Item d ÷ Item e)	75.14%
(g) Total sales including sales tax	254,088
(h) Nongrocery taxable sales per books, including sales tax (if such sales are not 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
(k) Sales of taxable items including sales tax (Item g – Item j)	86,835
(l) Less taxable items purchased with food stamps (2% of total 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
(n) Sales tax included (7.50/107.50 x Item m)	5,919
(o) Measure of tax (Item m – Item n)	78,916
(p) Sales tax payable (7.50% x Item o)	5,919

**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.

The following example illustrates the use of the Purchase-Ratio Method of computing sales tax included when nongrocery taxable sales are not a factor:



**GROCERS**

**REIMBURSEMENT FOR SALES TAX INCLUDED IN TOTAL SALES**

**(CONT.) 0904.25**

**Facts:**

Total Grocery Sales including Sales Tax		\$1,250,000
Purchases:		
Food Products	\$ 750,000	75%
Grocery Taxable	<u>250,000</u>	25%
	<u>\$1,000,000</u>	100%

**Computation:**

Exempt Food Products Ratio:

$$\frac{750,000}{750,000 + 250,000 + 18,750 (7.50\% \times 250,000)} = 73.62\%$$

Total Sales Including Tax	\$1,250,000
Less Food Products (73.66% x 1,250,000)	<u>920,250</u>
Taxable Sales Including Tax	329,750
Less Taxable Items Purchased with CalFresh benefits (2% x total CalFresh EBT card purchases for period, e.g., 2% x \$100,000)	<u>2,000</u>
Taxable Sales Including Tax	<u>327,750</u>
Sales Tax Included (7.50/107.50 x \$327,750)	<u>22,866</u>
Taxable Sales (ex-tax)	<u>\$304,884</u>

**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<sup>1</sup>. 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 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 CalFresh benefits may claim a deduction for EBT card purchases using CalFresh benefits of taxable merchandise sold.

Retailers are prohibited from collecting sales tax reimbursement on items purchased with CalFresh benefits even though such purchases are taxable when purchased with cash. The United States Department of Agriculture, Food and Nutrition Service (FNS) ensures that retail food stores are not charging sales tax on eligible food items purchased with CalFresh benefits. 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.

<sup>1</sup> See <http://www.calfresh.ca.gov/>

**CALFRESH PROGRAM (FORMERLY FOOD STAMPS)**

**(CONT.1) 0904.30**

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.

When a retailer receives payment partly in the form of cash and partly from CalFresh benefits, the 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 CalFresh benefits should be handled:

In this example the customer is paying for their groceries with \$15.00 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 eligible to be purchased with CalFresh benefits)	<u>5.00</u>
d. Total Purchases	<u>\$60.00</u>
e. Debit to CalFresh account	15.00
f. Cash Received (includes .75 tax)	<u>45.75</u>
Total Paid	<u>\$60.75</u>
Amount of Sale Subject to Sales Tax (a – e + c)	<u>\$10.00</u>

If this customer had 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 to be purchased with CalFresh benefits.

Retailers are authorized to report the deduction for 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 CalFresh benefit purchases made in the period for which the return is filed. 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 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 CalFresh benefits. For example, assume the following total purchases for reporting period:

Taxable items eligible to be purchased with CalFresh benefits	\$5,000 <sup>(a)</sup>
Exempt food products	130,000 <sup>(b)</sup>

The allowable percentage to be applied to the retailer's total purchases with CalFresh benefits 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 purchases made with CalFresh benefits, the amount recorded as total 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 purchases made with CalFresh benefits of eligible taxable items. If a 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.).

**CALFRESH PROGRAM (FORMERLY FOOD STAMPS)****(CONT.2) 0904.30**

Retailers who report on the tax accrual method are accounting for purchases made with 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 deduction for purchases made with CalFresh benefits for taxpayers reporting on the purchase-ratio method or “grocer’s formula” is explained in AM section 0904.25.

**TRADING STAMPS****0904.35**

Grocers may issue trading stamps in connection with sales made to customers. The cost of the stamps purchased by the grocer constitute cash discounts. Generally, grocers do not issue these stamps in connection with sales of distilled spirits, cigarettes, beer, wine, milk, or publications. (Refer to Chapter 4 regarding appropriate reimbursement of tax.)

The deduction for trading stamps is allowable only on the cost of stamps given in connection with taxable sales. In computing the deductible amount for trading stamps, the cost of the trading stamps should be prorated between the taxable and exempt sales on which stamps are given. The ratio may be computed on a test basis, i.e., the ratio obtained after adjusting taxable and total sales for a representative period, by the amount of taxable and total sales respectively, on which stamps are not given. This procedure should be followed in all cases where the adjustments would affect the ratio significantly and the deduction is of material consequence. See Regulation 1700(b)(5)(A)(2) for excess tax reimbursement on trading stamps.

In some cases, this procedure may not be necessary. In the case of many small stores where the amount of stamps involved is minor, the deduction may be based on the unadjusted taxable sales ratio. This short-cut procedure should be used only when the result of adjusting for sales on which stamps are not given, would be insignificant.

Often trading stamp companies rebate part of the cost of the stamps above a certain percentage of sales. Miscellaneous sources of income should be examined for such rebates.

**BOTTLE DEPOSITS AND OVER-RINGS****0904.40**

Bottle deposits are not part of gross receipts from sales. If such deposits are segregated, they will be excluded from total sales. In this case, care should be exercised to insure that refunds of such deposits are not netted from total sales. If it is established that bottle deposits are included in total sales, but that refunds of such deposits have been treated as cash payouts and not netted from total sales, the deduction claimed for this item should be allowed without further verification unless it is out of proportion to the volume of sales. When deposits are not segregated but are included in total sales, and deposit refunds are netted from total sales, it will be presumed in the absence of evidence to the contrary, that the total deposits received are equal to the deposits refunded.

Deductions claimed for over-rings, if reasonable, may be allowed without further verification. If this deduction appears excessive, verification should then be made by test checking the documents supporting the over-rings for several scattered days.

**MEAT SCRAPS SOLD AS BY-PRODUCTS****0904.45**

Meat scraps sold to rendering plants should be treated as sales for resale. These sales should be excluded from total grocery sales for purchase-ratio purposes. Since these are sales of a by-product, no adjustment should be made to the cost of meat purchases.

**BAD DEBTS****0904.50**

Grocers can claim a bad debt deduction for the amount of taxable sales reported and paid that were found to be uncollectible and charged off for income tax purposes. For grocers, bad debts are normally due to customer checks that were returned unpaid by the bank.

Since some grocers may fail to claim a bad debt deduction, auditors should determine whether a taxpayer is entitled to a bad debt deduction. If a taxpayer is entitled to claim a bad debt deduction and failed to do so, the auditor should inform the taxpayer of the information necessary to properly claim this deduction (Regulation 1642) and make any necessary adjustments in the audit based on the information provided by the taxpayer.

Since a single sale by a grocer normally includes both taxable and nontaxable items, a grocer's bad debt deduction may be determined by multiplying the total bad debts by the ratio of total taxable sales to total sales for the reporting period (or audit period). A bad debt deduction should be claimed in the period that the amount was found worthless and charged off for income tax purposes.

When a check is cashed for an amount in excess of the total sale, that excess portion over the sale amount is not deductible as a bad debt. Chapter 4 Section 0419.00 discusses further audit procedures and special considerations for bad debt deductions.

**MISCELLANEOUS OTHER DEDUCTIONS****0904.55****Prepaid Telephone Debit Cards**

Sales of prepaid telephone debit cards are not subject to tax. These transactions are considered sales of future telephone service rather than sales of tangible personal property.

However, a sale of a prepaid telephone card for its value as a collectible item rather than for future telephone service is a sale subject to tax. This also holds true when the card is resold after the telephone service expires or is fully depleted. New cards sold as collectibles often have a small amount of future telephone service included in the price. Cards sold for a price that exceeds the value of any included telephone service are sold for their value as collectibles.

**Point-of-Sales Fees**

Tax does not apply to separately stated charges representing fees for using a debit card. Such fees are related to bank fees and are not considered compensation for a sale. See Regulation 1643.

**Vending Machine Commissions**

Commissions received from vending machine operators who have placed vending machines in a grocer's store are not subject to tax. However, if a grocer sells its own products through vending machines see Regulation 1574, Vending Machines Operators.

**GROCERS' REPORTING METHODS****0905.00****GENERAL****0905.05**

Grocers may use any method of determining the amount of exempt food sales and taxable items so long as the method used accurately discloses the correct amount of tax due. Regardless of the method used, the taxpayer must demonstrate, by records which can be verified by audit, that the method used accurately discloses the correct amount of tax.

Grocers generally use one of the following methods of reporting taxable sales:

- (a) Purchase-Ratio Method. (See Section 0906.00)
- (b) Modified Purchase-Ratio Method. (See Section 0907.00)
- (c) Cost Plus Markup Method — Taxable Merchandise. (See Section 0908.00)
- (d) Retail Inventory Method. (See Section 0905.10)
- (e) Extending Taxable Merchandise to Retail Price. (See Section 0905.15)
- (f) Electronic Scanning Systems. (See Section 0912.00)
- (g) Sales Tax Ring-Up Method. (See Section 0905.20)
- (h) Taxable Sales Ring-Up Method. (See 0905.25)
- (i) Estimating. (See Section 0905.30)
- (j) Two or more of the above methods.

**RETAIL INVENTORY METHOD****0905.10**

Under this method (see Regulation 1602.5), all purchases are immediately priced at retail and all control records reflect the retail values. As a rule, its use by grocers is restricted to the larger chain organizations.

Verification procedure to be used is the same as in Section 0905.15.

**EXTENDING TAXABLE MERCHANDISE TO RETAIL METHOD****0905.15**

This reporting method contemplates that the taxpayer will report tax based on the retail selling price of all taxable purchases during a reporting period rather than on actual taxable sales made during the period.

Verification procedure should cover:

- (a) Accuracy of total purchases.
- (b) Accuracy of purchase segregation.
- (c) Accuracy of extensions.
- (d) Accuracy of adjustments for inventory fluctuations.
- (e) Accuracy of adjustments for markdowns, markons, quantity sales and case sales.
- (f) Accuracy of adjustment for shrinkage. (See Section 0909.00)
- (g) Accuracy of adjustment for self-consumption. (See Section 0903.10)

**SALES TAX RING-UP METHOD****0905.20**

Under this method, sales tax ring-ups at the cash register are converted to the equivalent taxable measure to determine taxable sales for the reporting period. Use of this method is generally not satisfactory because of several factors. For example:

- Checkout clerks may not be well informed on the taxability of all items sold.
- Checkout clerks often work under pressure, which can lead to errors in classifying items or errors in the amount of tax reimbursement added.
- It is sometimes trade practice to sell certain types of merchandise, such as cigarettes and tobacco, at a tax-included price.

Since this method is susceptible to many errors, auditors should be aware when a grocer utilizes it. Auditors should verify the following:

- (a) Accuracy of recorded sales tax by tracing cash register tape totals to sales register (or other sales summary books) for several representative periods.
- (b) Proper sales segregation on cash register tapes by testing a representative period using the markup method.

**TAXABLE SALES RING-UP METHOD****0905.25**

This method is similar to the sales tax ring-up method, except that under this method the taxable sales amounts are recorded on a separate key of the cash register and compiled to determine taxable sales for the reporting period. As with the sales tax ring-up method, this method is susceptible to many errors. Auditors should be aware when a grocer utilizes this method and use similar verification procedures discussed in Section 0905.20.

**ESTIMATES****0905.30**

The following methods for reporting tax liability based on estimates are not recommended, but may be found in use by the taxpayer:

- Estimates based on tax reported in a prior period.
- Estimates based on a ratio of taxable sales to total sales in a prior period.
- Estimates based on the application of unsubstantiated markups or based on other methods that have not been approved by the BOE.

Auditors should use appropriate markup methods to verify if the taxpayer's estimate reasonably discloses the correct amount of tax due.

**PURCHASE-RATIO METHOD**

**0906.00**

**GENERAL**

**0906.05**

If the taxpayer is reporting by use of the purchase-ratio method, the purchase-ratio method should be used for audit purposes unless it is determined that not all sales are recorded. In such instances, the markup method should generally be used.

The validity of the purchase-ratio method is based on the premise that the over-all markup on food products is the same as on taxable merchandise. Authorization for the use of this method is contained in Regulation 1602.5. Two basic methods used in reporting sales of exempt food products are:

(a) The "Simple Method"

Use of this method does not allow a tax included deduction.

Exempt Food Purchases		X	Taxable Grocery Sales (tax included)
Exempt Food Purchases + Taxable grocery purchases			

(b) The "More Accurate Method"

Exempt Food Purchases		X	Taxable Grocery Sales (tax included)
Exempt Food Purchases + Taxable Grocery Purchases + 7.25 * of Taxable Grocery Purchases			

\*Use applicable tax rate.

This method allows a tax included deduction. (See Section 0904.25).

The "Simple Method" is most often used by small grocers who would benefit only slightly by the additional calculations required by the "More Accurate Method." *If use of the "More Accurate Method" would result in a substantial difference, if tax included has been claimed, or if other revisions are required, the taxpayer should be given the benefit of the use of this method.*

Sections 0906.10 through 0906.50 describe the items to be included and excluded from the specific categories in the formula for the purchase-ratio method. Where concessionaire sales and purchases are included in the records, they should be eliminated before the computation of the food product percentage is made.

An example of the application of the purchase-ratio method is shown in Exhibits 1 through 4 following the text of this chapter.

**EXEMPT FOOD PURCHASES**

**0906.10**

This classification includes purchases of all items meeting the definition of food products for human consumption as defined in Section 6359 and Regulation 1602. Purchases for all grocery departments operated by the taxpayer such as meat, fruit, produce, delicatessen (except ingredients for hot prepared food or food sold for immediate consumption at facilities provided by the grocer), and bakery should be included.

Care should be taken to exclude from exempt food purchases all purchases of operating supplies, paper bags, and expense items since these are often billed along with groceries by the larger wholesale grocers.

**TAXABLE GROCERY PURCHASES****0906.15**

This classification includes purchases of all taxable items other than the type of items classified as “nongrocery taxable” in Regulation 1602.5. See Exhibit 8. It does not include purchases of gasoline, feed for farm animals, fertilizers, or purchases of ingredients for products sold in snack bars, restaurants, or as hot prepared food products, or sold for immediate consumption at facilities provided by the grocer (see Section 0906.45).

**SELF-PERFORMED COSTS****0906.20**

Exempt food purchases and taxable grocery purchases do not include the cost of processing, manufacturing, warehousing, transportation and other costs, if these operations are self-performed. Some examples of such costs are; meat cutting and wrapping, produce preparation, meat plant operation, milk plant operation, operating bakery department, preparation of cold salads in a delicatessen department, etc.

When the purchase-ratio method is used for reporting purposes, amounts subject to the ratio include only the cost of merchandise purchased from others, and excludes any self-performed additional costs.

If a grocer includes self-performed labor or overhead costs in the purchase-ratio method, he/she is using a modified purchase-ratio method. Grocers using a modified method must demonstrate that the method does not result in an overstatement of the food products deduction (see Section 0907.00).

**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 value of 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).

**BEVERAGE DEPARTMENT SALES****0906.30**

All beverage department sales and purchases, except distilled spirits and other nongrocery taxables, should be included in the formula calculations.



**VERIFICATION OF SEGREGATION****0906.35**

The taxpayer's purchase segregation should be verified for whatever test period or periods is deemed appropriate. The test must be a representative purchasing cycle for the taxpayer's business during the audit period. Care should be taken to include both cash and check purchases. Purchases from vendors known to deal exclusively in food products need not be examined. Certain vendors, whose sales are apparently limited to food products, however, do sell some taxable items:

- (a) Some large meat packing firms sell dog food and soap.
- (b) Some dairy product firms sell taxable carbonated beverages.
- (c) Fruit and vegetable wholesalers may sell flowers, potted plants, etc.

Some large wholesalers identify taxable items and show taxable totals on their invoices. While the totals of taxable purchases as shown on these invoices are generally accurate, individual items should be scanned on some invoices to verify that taxable items are correctly coded. The following items are often purchased and invoiced to grocers with regular merchandise and should be excluded from all calculations:

- (a) Paper bags, wrapping paper, and other container material.
- (b) Trading stamps.
- (c) Health insurance premiums.
- (d) Operating supplies.

**PURCHASE DISCOUNTS AND ALLOWANCES****0906.40**

The following discounts constitute a reduction in the cost of merchandise for purchase-ratio purposes:

- (a) Cash discounts.
- (b) Volume rebates or quantity discounts.
- (c) Promotional allowances.

If discounts of this type are significant, exempt food and taxable grocery costs should be reduced as appropriate when the purchase-ratio method is used. Since these discounts can apply to exempt food, taxable grocery, and nongrocery taxable items, a segregation test of the discounts may have to be made. These discounts are defined as:

**“Cash discount”** means a reduction from invoice price allowed the grocer for prompt payment.

**“Volume rebate or quantity discount”** means an allowance or reduction of the price for volume purchases based on the number of units purchased or sold. Such rebates or discounts normally are obtained without any specific contractual obligation upon the part of the grocer to advertise or otherwise promote sales of the products purchased. The term does not include patronage dividends distributed to members by nonprofit cooperatives pursuant to Section 12805 of the Corporations Code, or rebates which constitute a distribution of profits to members or stockholders.

**PURCHASE DISCOUNTS AND ALLOWANCES****(CONT.) 0906.40**

“**Promotional allowance**” means an allowance in the nature of a reduction of the price to the grocer, based on the number of units sold or purchased during a promotional period. The allowance is directly related to units sold or purchased although some additional promotional expense may be incurred by the grocer. Normally, the grocer would feature the product in his/her advertising, although he/she may or may not be contractually obligated to do so. The retail price of the product may or may not be lowered during a promotional period. The term does not include display or other merchandising plan allowances or payments which are based on agreements to provide shelf space for a price not related to volume of purchases, or cooperative advertising allowances which are based on a national line rate for advertising and are not directly related to volume of purchases and sales. Cooperative advertising allowances are intended to reimburse a grocer for a portion of his/her advertising costs for a particular product or products.

For information on payments received by retailers from rebates and other incentives see AM section 0437.25, *Rebates and Incentives*.

**NONGROCERY TAXABLE ITEMS****0906.45**

Regulation 1602.5 requires a grocer using the purchase-ratio method of reporting to make a separate accounting for taxable merchandise not regularly sold in a grocery store. Generally, it will not be productive to adjust for non-grocery taxable items where the annual gross sales are less than \$200,000. For taxpayers with annual gross sales over \$200,000, purchases of such items should be segregated from grocery department purchases in the taxpayer’s records. Where this is done, verification can be performed in conjunction with testing of food products distribution. See Regulation 1602.5 and Exhibit 8 for listings of representative nongrocery taxable items.

In some cases, grocers estimate nongrocery taxable purchases. Unless the auditor is completely satisfied that it is unwarranted, the auditor should list these purchases for a test period. This should also be done, of course, in those cases where nongrocery taxable items have been completely ignored, unless they are insignificant (see Section 0906.15).

When a grocer uses the purchase-ratio method for reporting purposes, and sales of nongrocery taxable (NGT) items are computed by the markup method, the NGT inventory adjustment is usually ignored.

*If the audit discloses a material fluctuation in beginning and/or ending inventories of NGT items, appropriate adjustments should be made.* This situation may arise in new stores, close-outs, or when a NGT inventory is expanded. For example, in a new business, if the beginning inventory was recorded in purchases, an adjustment for the ending inventory must be made to avoid overstating the cost of sales.

The details of the adjustment should be clearly explained in the audit working papers for future audit reference.

The facts concerning the handling of inventories can most easily be determined during the first audit of a taxpayer.

If applicable, adjustments for shrinkage should also be made (see Section 0909.00).

**NONGROCERY TAXABLE MARKUP****0906.50** |

Markup calculations, whether made to establish selling price or to confirm adequacy of markup used by the taxpayer should conform to the provisions of Chapter 4. Sales tax should be added to the selling prices in the shelf test or added to the computed sales.

**SHORT-CUT PROCEDURE****0906.55** |

Where it is found that there have been no errors of a kind requiring quarterly recalculations of sales of food products, the accuracy of the taxpayer's computations may be verified by:

- (a) Computing a single food products percentage for the entire audit period, or for as long a period as is practicable. After application of this percentage to total sales, the deduction should not vary significantly from reported amounts. However, wide fluctuations in quarterly food percentages could distort the results and this procedure should not be used under such circumstances.
- (b) Visual inspection for unusual variations in food percentages accompanied by a test check of the accuracy of the taxpayer's calculations for several periods.

**MODIFIED PURCHASE-RATIO METHOD****0907.00****GENERAL****0907.05**

Any grocer who does not follow the purchase-ratio procedure as outlined in Regulation 1602.5, but reports on a purchase ratio basis of some type is using a modified version of the purchase-ratio method. For example, grocers who include self-performed processing, manufacturing, warehousing or transportation costs in the purchase-ratio formula are using a modified version. Any grocer using such a modified version must establish that his/her modified version does not result in an overstatement of the food products exemption. However, if a small grocer is using a modified version of the formula, the significance of the potential error must be considered, since it may be immaterial.

**GROCERS MUST SUBSTANTIATE PROCEDURE****0907.10**

As provided in Regulation 1602.5, a grocer may demonstrate the adequacy of his/her modified method by extending taxable purchases, adjusted for inventories, to retail for a representative period or by computing taxable sales by marking up taxable purchases, adjusted for inventories, for a representative period.

## GROCERS

### **COST PLUS MARKUP METHOD — TAXABLE MERCHANDISE 0908.00**

#### **GENERAL 0908.05**

If the taxpayer is reporting by use of the markup method, the markup method should be used for audit purposes. The purchase-ratio method may be used for testing purposes. However, any recommendation for assessment or refund must be supported by the markup method.

When the markup method is used for audit purposes, the guidelines on markup procedures outlined in Chapter 4 (Section 0407.10) should be followed. Effect should be given to markons, markdowns, shrinkage, self-consumption and inventory fluctuations. The audit procedures should also be consistent with the “cost plus markup method” guidelines set forth in Regulation 1602.5 and Section 0908.10. Additionally, all audit assessments using the markup method should include a short test (e.g., markup analysis of taxable and nontaxable sales using audited sales, net income analysis using unreported sales, or other analyses discussed in Sections 0406.40 and 0405.25) to support the reasonableness of the audit assessment in the audit working papers.

#### **GROCER TO USE SPECIFIC PROCEDURE 0908.10**

Regulation 1602.5 directs grocers who elect to use the cost plus markup method of reporting to follow certain procedures in determining and using taxable markup factor percentages to compute taxable sales. Briefly, the grocer must determine markup factor percentages by commodity groupings by making a shelf test of purchases covering a minimum purchasing cycle of one month within a three-year period. The markup factor percentages are then applied to the cost of sales of the respective commodity groupings for the reporting period to compute taxable sales for the reporting period. See Section 0407.15 for discussion of markup procedures. Auditors should note some specific procedures associated with grocer markups e.g., using current sales prices and purchase figures, accounting for single/multi-pack items, and properly handling tax-included and ex-tax sales prices.

As an alternate procedure, the overall average taxable markup factor percentage may be determined and applied to the overall cost of taxable sales for the reporting period as explained in Regulation 1602.5. An example of the alternate procedure and the type of commodity groupings contemplated is illustrated by Exhibits 5 through 7.

Grocers should be urged to follow these procedures when reporting by the markup method.

**SHRINKAGE****0909.00****REPORTING METHODS****0909.05**

The term “shrinkage” means unaccounted for losses due to spoilage, breakage, and pilferage. Grocers who incur such losses may, for reporting purposes, adjust for such losses in one of the following ways:

- (a) Compute a loss adjustment of up to 1 percent of the cost of all their taxable merchandise when either the retail inventory or markup method is used for reporting purposes.
- (b) Compute a loss adjustment of up to 3 percent of the cost of their nongrocery taxable merchandise only when the purchase-ratio method is used for reporting purposes and sales of nongrocery taxable items are computed by the retail extension or markup method. This adjustment is limited to an overall 1 percent of taxable purchases if some method other than the purchase-ratio method is used for reporting purposes.

Losses in excess of the above are allowable when evidence shows that a greater loss was sustained.

*All audits that include a shrinkage allowance should contain detailed comments supporting the shrinkage allowance in the audit working papers.* The shrinkage allowance should also be translated from a percentage to dollars, and a breakdown of the volume and type of merchandise the dollars represent should be included in the audit working papers comments.

**EVIDENCE OF ADDITIONAL LOSSES****0909.10**

Support for additional losses may consist of:

- Police reports
- Reports from regularly employed security guards
- Private detective agencies or similar service firms
- Insurance claims and settlements
- Losses computed through inventory reconciliations

**AUDIT ADJUSTMENTS****0909.15**

If the auditor determines that a grocer has not claimed a shrinkage allowance or has claimed less than the allowance specified, an audit adjustment for additional shrinkage should be made. It should be verified that the markup factors used by the grocer to compute reported taxable sales have been accurately computed and are not simply estimates. If this can be shown, or if it is necessary to recompute markup factors for audit purposes, adjustments for shrinkage, within the limitations of Regulation 1602.5, should be made. This matter should be discussed with the grocer at the time of audit.

In the majority of markup audits a 1% to 3% shrinkage allowance is reasonable. However, there may be circumstances that justify a higher allowance. In some instances, an allowance greater than 3% may be justified if fully supported. *All audits that include a shrinkage allowance should contain detailed comments supporting the shrinkage allowance in the audit working papers. In uncommon situations where no adjustment is made for shrinkage, detailed comments should be provided to substantiate that a shrinkage allowance is not warranted.*

While the location of the business is an important factor, there are other considerations as well. Often, when business owners perceive that a higher rate of pilferage might occur, they take precautions to minimize losses, e.g. liquor stores often keep high pilferage inventory (such as cigarettes and liquor) behind the counter, or use security/surveillance cameras to monitor the activity of customers. These types of precautions often result in a business having only the normal 1% pilferage rate even though they are located in areas where a higher rate of pilferage is perceived. Auditor comments should include information about security and surveillance measures, location of cash registers and store layout in audits recommending more than a 1% shrinkage allowance, or when the 1% allowance is in dispute.

The shrinkage allowance should also be translated from a percentage to dollars, and a breakdown of the volume and type of merchandise the dollars represent should be included in the audit working papers comments.

**CREDIT FOR CLOSING INVENTORY****0910.00**

Where a retailer has made sales tax returns by marking up all taxable purchases or by marking up nongrocery taxable purchases (plus opening inventory, if any) to anticipated retail prices, a credit or refund of tax measured by the amount of the closing inventory will be in order.

Under such a situation, the provisions of Section 6908 of the Sales and Use Tax Law would preclude allowance of interest on a refund.

The following guidelines should be observed whenever the markup method has been used:

- (a) A credit or refund measured by the increase in inventory is allowable, even if the taxpayer omitted the opening inventory from the markup computation.
- (b) The same principle applies even if the markup method was used only for one phase of a business, such as nongrocery taxable sales. However, when such an adjustment is made with respect to nongrocery taxable sales, and the taxpayer has otherwise used the purchase ratio method, an adjustment to total grocery sales may also be necessary for ratio purposes.
- (c) To avoid establishing a tax paid inventory when using the markup method for audit purposes, the markup should always be applied to cost of goods sold rather than to purchases. This procedure should be made clear in the audit working papers.

If purchases are considered to constitute cost of goods sold because inventories are consistent, unavailable, and/or unreliable, the audit comments should so state.

- (d) After an audit is made, all inventories should be left on an ex-tax basis even if it is necessary to recommend a refund to accomplish this. A comment stating that inventories were left on an ex-tax basis should be made on the back of the BOE-414-A.

The taxpayer should be advised to use cost of goods rather than purchases, for markup purposes, to avoid establishing a tax paid inventory.

- (e) When computing a tax paid inventory credit, the statute of limitations is not a factor. Inventory fluctuations all the way back to the inception of the present ownership of the business, or to the earliest date where reliable information regarding inventories, purchases, and reporting method is available, should be considered. This approach is based on the first in first out inventory principle, so that overreporting resulting from inventory accumulation is considered to have occurred in the most recent reporting period or periods.
- (f) A markup reporting method applied to purchases rather than cost of goods sold, over an extended period of time, can result in distortions of tax liability if the tax rate has changed one or more times during the period. However, the significance of any such variance generally would not warrant the expenditure of time which would be required to adjust for this factor.
- (g) When making adjustments of this nature, proper effect must be given to documented fire losses, burglary losses, shrinkage, self-consumption, etc.
- (h) The beginning inventory will be considered tax paid only if it can be shown that it was included in the amounts marked up and reported, or that separately stated tax reimbursement was paid to the retailer from whom the beginning inventory was purchased.



**ELECTRONIC SCANNING SYSTEMS****0912.00****GENERAL****0912.05**

Electronic scanning systems utilize electronic scanners and central computers to automatically compile and record taxable and nontaxable sales, sales tax, and related data from scanning of products imprinted with the Universal Product Code (UPC). For grocers using scanning system results for sales tax reporting purposes, it is important to ensure that proper controls are maintained for monitoring and verifying the accuracy of the scanning results and tax returns. For example, the scanning programs relating to product identity, price, sales tax code, program changes and corrections, etc., must be retained for future examination by the BOE's audit staff. Records which clearly show a segregation of taxable and nontaxable merchandise purchases would also provide grocers and the BOE with additional data from which the scanning accuracy may be monitored or verified.

**PURCHASE SEGREGATION MAY BE REQUIRED****0912.10**

Regulation 1602.5 provides that a grocer may use any method of reporting which can be supported as properly reflecting sales of exempt food products. However, it is the grocer's responsibility to establish the propriety of the amount of the claimed deduction. Therefore, if the accuracy of the claimed deduction for sales of exempt food products cannot otherwise be verified, the grocer should, in the absence of segregated purchases, be required to segregate at least a representative sample of purchases (e.g., purchasing cycle) to provide a basis for verification of the claimed deduction.

## RECORD KEEPING REQUIREMENTS

0912.20

In addition to the normal books of account that ordinarily must be maintained by a prudent businessperson, the following records should also be developed and retained by all grocers reporting by use of electronic scanners:

**(a) Master Listings** — All grocers whether they are independent stores or a chain store operation, should maintain a master listing of all products sold, both taxable and nontaxable. Audit experience involving chain store operations has shown that occasionally, individual stores (within the chain) will maintain their own “Master List.” Grocers should ensure that their programs are consistently applied throughout their operations. If the grocer also sells products that are not included in the “Master List,” (products without a UPC such as salad bars, seasonal items, deli items, etc.) a separate accounting should be maintained for these products. Regardless of the type of media used to maintain the list, it should include substantially all of the following product information:

1. The Universal Product Codes.
2. The product’s taxable or nontaxable status.
3. An identifying description of the product.
4. The package or size of the product.
5. The stores that carry the product.
6. Department numbers.
7. A warehouse or vendor item number.

**(b) Product Coding Reports** — It is of paramount importance that an audit of a grocer, reporting by use of an electronic scanner, includes a review of the grocer’s product codes to verify that the products were coded accurately throughout the audit period. The product mixes of the grocery industry are dynamic. New or improved products, which may number in the hundreds, are continually introduced. As such, decisions to add or discontinue product(s) can be made on a daily basis. As a result, a grocer’s “Master List” could change daily and recent audits have disclosed that many grocers are not retaining a sufficient record of changes made to their product codes. In many cases, a single store may carry anywhere from 30,000 to 140,000 different items. Therefore, without a history of product changes, it would be virtually impossible for an auditor to determine if a grocer’s sales of exempt food products (using electronic scanners) are properly supported.

In order to test the product codes on a historical basis, retailers will be required to prepare and save a minimum of one “Product Coding Report” (PCR) for each return reporting period. This report should include all additions or new products, deletions of old products, and coding changes of existing products that have occurred since the preparation of the prior period’s report.

Requiring grocers to save the PCR for each designated reporting period will assist grocers in identifying and correcting any possible coding errors within the same reporting period they occurred. Otherwise, grocers would be subject to interest and penalty adjustments for any coding errors not disclosed until later reporting periods.

## RECORD KEEPING REQUIREMENTS

(CONT.) 0912.20

**(c) Product Movement Report** — Regardless of the size of the grocer, a “Product Movement Report” or a similar type of inventory tracking report should also be generated and maintained over the same reporting period required for the Product Coding Report. Essentially, this report should include the same product information contained in the Master Listing. If product coding errors are identified by a retailer, this report should assist the retailer in determining the quantity and price of product(s) sold during the reporting period and allow him/her to compute the additional sales tax due.

This report should also provide the auditor with a sufficient audit trail to verify what products were miscoded, when the erroneous coding was corrected, the price of the product, and how much of the product was sold during the period in question. If excess tax reimbursement is indicated, it should be handled in accordance with the requirements set forth in Sales and Use Tax Regulation 1700.

**GENERAL OUTLINE OF REPORTS, RECORDS AND PROCEDURES****0912.25**

When reporting with electronic scanners, grocers should keep a general outline of their electronic scanner reporting methods for auditors to use as a means of verifying that proper controls are maintained to monitor the accuracy of the scanning results. 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 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?

AUDIT MANUAL

TABLE OF EXHIBITS

Computation of Percentage of Error  
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Application of Purchase Segregation Test  
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(Purchase-Ratio Method).....[12A-6].....Exhibit 4

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Computation of Overall Taxable Markup  
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Classification of Products Sold by Grocers .....Exhibit 8

GROCCERS

**COMPUTATION OF PERCENTAGE OF ERROR  
FOR CLAIMED FOOD PRODUCTS**

[12A-1]

EXHIBIT 1

Computation of Percentage of Error  
for Claimed Food Products

12A-1
SR - AA - 98-000000
J.B.L
10/18/20xx

	A	B	C	D	E		
REF							
1	<12A-4>	Audited Taxable Grocery Purchases			897,622		
2	(L1 x .0725)	Sales Tax Differential @ 7.25%			65,078		
3	<12A-4>	Audited Food Purchases			4,292,209		
4	(L1 + L2 + L3)	Total Audited Grocery Purchases			<u>5,254,909</u>		
5	(L3 / L4)	Food Products Ratio			<u>81.68%</u>		
6							
7	<414>	Total Sales Reported (tax included)			6,821,060		
8							
9		less Non-Grocery Taxable Sales:					
			<table border="1"> <tr> <td>Non-Grocery Taxable</td> <td>Distilled Spirits</td> </tr> </table>		Non-Grocery Taxable	Distilled Spirits	
Non-Grocery Taxable	Distilled Spirits						
10							
11	<12A-4>	Audited Purchases	286,887	143,683			
12	(L11 x .03)	less Shrinkage @ 3%	8,607	4,310			
13	(L11 - L12)	Adjusted Purchases	278,280	139,373			
14	<12A-2>	Markup Factor (tax included)	155.3%	134.1%			
15	(L13 x L14)	Non-Grocery Taxable Sales	<u>432,169</u>	<u>186,899</u>	619,068		
16							
17	(L7 - L15)	Audited Grocery Sales			6,201,992		
18							
19	(L5 x L17)	Audited Food Products			<u>5,065,787</u>		
20	<414>	Claimed Food Products			<u>5,187,410</u>		
21	(L20 - L19)	Difference			<u>121,623</u>		
22							
23	(L21 / L20)	Percentage of Error			<u>2.34%</u>		
24					<12A>		

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**APPLICATION OF PURCHASE SEGREGATION TEST  
(PURCHASE-RATIO METHOD)**

[12A-4]

EXHIBIT 2

Application of Purchase Segregation Test  
Audit Period 7/1/19zz through 6/30/20xx

12A-4
SR - AA - 98-000000
J.B.L
10/18/20xx

	A	B	C	D	E	F	G	
							(C+D+E+F)	
REF		PERIOD	Food Products	Taxable Grocery	Taxable Non-Grocery	Distilled Spirits	Total	
1		7/1/19zz - 6/30/19yy	1,662,593	345,568	72,349	43,196	2,123,706	
2		7/1/19yy - 12/31/19yy	2,008,012	469,767	99,011	58,721	2,635,511	
3		1/1/20xx - 3/31/20xx	299,541	72,303	18,910	9,038	399,792	
4		4/1/20xx - 6/30/20xx	338,475	85,859	26,306	10,752	461,392	
5		These percentages are applied to total recorded purchases figures	Total	4,308,621	973,497	216,576	121,707	5,620,401
6	<12A-5>	Segregation Error	-0.292%	-1.350%	1.251%	0.391%		
7	(L6 x Col G,L5)	Change	-16,412	-75,875	70,311	21,976	0	
8		Adjusted Purchases	4,292,209	897,622	286,887	143,683	5,620,401	

<12A-1>

This schedule illustrates one method of proper application of the results of segregation test of purchases for a test period to total recorded purchases for the entire audit period. The taxpayer segregated the purchases as indicated.

		For Comparison Only	These purchases are applied to appropriate class of recorded purchases (line 5).				
16	<12A-5>	Segregation Error (Relative)	-0.40%	-7.86%	18.24%	15.94%	0.00%
17	(L5 x L16)	Change	-17,234	-76,517	39,503	19,400	-34,848

“Difference” in purchases (due to method of application).

Note that application of a percentage of error by category, rather than by relation to total purchases for the test period, results in a distortion as illustrated. This method is inaccurate because it results in a difference between audited and recorded purchases, even though only the segregation of purchases by the taxpayer is being questioned. If errors that affect total purchases are made by taxpayers, adjustments should be made by the auditor as necessary

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**RESULTS OF PURCHASE SEGREGATION TEST  
(PURCHASE-RATIO METHOD)**

[12A-5]

EXHIBIT 3

Results of Purchase Segregation Test  
January 20xx

12A-5
SR - AA - 98-000000
J.B.L
10/18/20xx

REF	A	B	C	D	E	F
		Result of test — various errors in segregation				
		References	<b>Food Products</b>	<b>Taxable Grocery</b>	<b>Taxable Non-Grocery</b>	<b>Distilled Spirits</b>
1	<P/J>	Recorded Purchases	117,288	27,408	10,943	3,915
2	<12A-6>	Error Adjustments per Examination	-466	-2,154	1,996	624
3						
4		Percentage of Error to Total Purchases	-0.292%	-1.350%	1.251%	0.391%
5			(C ÷ G)	(D ÷ G)	(E ÷ G)	(F ÷ G)
6			<12A-4>			
7						
8		Percentages of error — based on relation to total purchases during test period.				
9						
10						
11		For comparison only				
12	(L2/L1)	Percentage of Error to Recorded Category	-0.40%	-7.86%	18.24%	15.94%
13			<12A-4>			

Percentages of error — based on relation to differences by separate category.

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**EXAMINATION OF PURCHASES  
(PURCHASE-RATIO METHOD)**

[12A-6]

EXHIBIT 4

Examination of Purchases  
Test Period - January 20xx

12A-6
SR - AA - 98-000000
J.B.L
10/18/20xx

A	B	C	D	E	F	G	H	I	J	K	
(J ÷ E)											
< Adjustment per Audit >											
REF	Date	Vendor	Invoice Number	Items	Cost per Invoice	Food Products	Taxable Grocery	Non-Taxable Grocery	Distilled Spirits	Selling Price	Markup Factor
1	1/17/20xx	Moore Clark	16589	Kites	54.65		-54.65			81.60	
2	1/20/20xx	Moore Clark	13366	Sundries	100.87					150.61	
3	1/25/20xx	Moore Clark	742	D/S			-272.50		272.50		
4											
5											
6	1/2/20xx	Hostess Prides	20151	Tools	154.47		-154.47	154.47		230.34	
7	1/30/20xx	Blackwood Co.	471	Grape Juice Bars		12.00	-12.00				
8				Total	6,309.00	-466.00	-2,154.00	1,996.00	624.00	9,243.00	146.50%
9											
10											

This schedule illustrates a method of combining an analysis of recorded purchases with a markup computation for taxable nongrocery sales.

The taxpayer has used a markup of 34.1%, including tax, on distilled spirits. This has been accepted by the auditor.

This schedule might also be used for a test to delete supplies recorded as purchases.

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**COMPUTATION OF TAXABLE SALES TO BE REPORTED  
(COST PLUS MARKUP METHOD)**

[12A-1]

EXHIBIT 5

COMPUTATION OF TAXABLE SALES  
TO BE REPORTED  
PERIOD: THIRD QUARTER 1999

12A-1
SR AA 98-000000
K.S.
09/08/20XX

	A	B	C	D	E	F	G	H
REF								

1

2

3

4

5

6

7

8

9

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11

12

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30

RECORDED COST OF TAXABLE SALES	403,815
LESS: SELF CONSUMPTION	① 100
ADJUSTED COST OF SALES	403,715
LESS: 1% ALLOWANCE FOR SHRINKAGE	4,037
ADJUSTED COST OF SALES	<u>399,678</u>

<12A-2> OVERALL TAXABLE MARKUP FACTOR	
(31.68% + 100.00%)	② <u>131.68%</u>

COMPUTED TAXABLE SALES	
(131.68% * \$399,678)	<u>526,296</u>

COMPUTED SALES TAX PAYABLE	
(7.25% * \$526,296)	③ <u>38,156</u>

1. Estimate for illustrative purposes only. Self consumption should be computed in accordance with A.M. 0903.10.
2. Supporting markup computation illustrated herein.
3. Use applicable rate of tax - tax rate of 7.25% used for illustration purposes.

**INSTRUCTIONAL NOTE:**  
Exhibits 5, 6, & 7 are illustrative of the procedure to be followed by taxpayers when making a test using the "Cost Plus Markup Method" noted in Section (b) (3)(B) of Regulation 1602.5 and as referred to in A.M. 0908.10.

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**COMPUTATION OF OVERALL TAXABLE MARKUP  
(COST PLUS MARKUP METHOD)**

[12A-2]

EXHIBIT 6

COMPUTATION OF OVERALL  
TAXABLE MARKUP  
TEST PERIOD: APRIL 1999

12A-2
SR AA 98-000000
K.S.
9/7/20XX

REF	A	B	C	D	E	F
					<12A-3>	(DXE)
				<b>RECORDED COST OF SALES</b>	<b>① MARKUP FACTOR (MU + 100%)</b>	<b>COMPUTED TAXABLE SALES</b>
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13						
14						
15						
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						

REF	A	B	C	D	E	F
					<12A-3>	(DXE)
				<b>RECORDED COST OF SALES</b>	<b>① MARKUP FACTOR (MU + 100%)</b>	<b>COMPUTED TAXABLE SALES</b>
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13						
14						
15						
16						
17						
18						
19						
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21						
22						
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24						
25						

1. All markups have been adjusted for any price changes.
2. Supporting shelf test of markup computation illustrated herein (<12A-3>), others not shown.
3. Markup on total nongrocery taxables has been computed in the normal manner.

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GROCGERS

SHELF TEST (COST PLUS MARKUP METHOD)

[12A-3]

EXHIBIT 7

SHELF TEST  
TEST PERIOD: APRIL 1999

12A-3
SR AA 98-000000
K. S.
9/7/20XX

REF	A	B	C	D	E	F
	DATE	INVOICE NUMBER	VENDOR	GENERAL DESCRIPTION	COST	RETAIL EXTAX
1						
2						
3						
4	04/02/99	629452	LANE DISTRIBUTING CO	BEER	559.64	737.00
5	04/02/99	39819	NATIONAL BREWERS	BEER	222.72	297.20
6	04/04/99	45293B	CITY DISTRIBUTORS	BEER	553.78	737.52
7	04/07/99	98757	SMYTHE BREWING CO	BEER	475.66	620.11
8	04/07/99	75923	BUNKERS BREWERS INC.	BEER	173.10	237.79
9						
10						
11						
12				TOTAL	\$6,466.38	\$ 8,540.54
13				COST		\$ 6,466.38
14				GROSS PROFIT		\$ 2,074.16
15				MARKUP (\$2,074.16/\$6,466.38)		32.08%
16						<12A-2>
17						
18						
19						
20	04/03/99	123276	MONSANTO-PACIFIC, INC.	PAPER TOWELS	962.59	1,152.80
21	04/03/99	B30031	VALUE-LINE PRODUCTS	NAPKINS, PAPER PLATES	514.29	696.50
22	04/05/99	191156	LUNCH A BUNCH BAGS	LUNCH BAGS	396.31	504.35
23	04/08/99	42445A	FAWCETT & SON	TISSUES	1,204.14	1,584.45
24	04/08/99	19416	M.I. GREEN PAPER CO	ALUMINUM FOIL	481.52	601.14
25						
26						
27						
28				TOTAL	\$9,840.85	\$12,672.92
29				COST		\$ 9,840.85
30				GROSS PROFIT		\$ 2,832.07
31				MARKUP (\$2,832.07/\$9,840.85)		28.78%
32						<12A-2>
33						
34						
35						
36	04/03/99	314652	SILVER SEAL PRODUCTS	BLEACH	192.23	224.96
37	04/03/99	B92845	LEWIS & FINAL	AMMONIA	262.01	330.29
38	04/05/99	1-22958	COLUMBIA LAUNDRY PRODUCTS	STARCH	268.92	324.42
39	04/08/99	496372	ARNILE & CO	WATER SOFTENER	180.47	234.87
40	04/08/99	A19485	GOLDFARD & HUBBARD, INC.	CLEANERS	190.52	240.75
41						
42						
43						
44				TOTAL	\$2,152.85	\$ 2,663.46
45				COST		\$ 2,152.85
46				GROSS PROFIT		\$ 510.61
47				MARKUP (\$510.61/\$2,152.85)		23.72%
48						<12A-2>

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Date: \_\_\_\_\_

## CLASSIFICATION OF PRODUCTS SOLD BY GROCERS

## EXHIBIT 8

**A. TAXABLE GROCERY ITEMS**

Examples of "taxable grocery items" regularly sold in grocery stores include the following:

Aluminum Foil	Kleenex
Ammonia	Kotex, Tampax
Antacid Mints	Laundry Soap
Asphalt Tile Cleaner	Light Bulbs and Fuses
Bags – Lunch	Lighter Fluid
Beer	Lozenges (medicated)
Bird Seed	Matches
Bird Treats (food)	Mops, Mop Handles
Bleach – Laundry	Moth Protection – All Kinds
Bottle Brushes	Muffin Papers
Brooms	Paper Cups, Plates, Napkins
Candles	Paper Towels
Canning Jars and Lids	Plastic Eating Utensils
Carbonated Beverages (sodas)	Plastic Film/Wrap
Cat Food	Powder (cleaning)
Charcoal Briquettes	Rolaids
Cigarettes	Rust Stain Remover
Cigars	Salt – Ice Cream
Cleaners and Polishes (household)	Sandwich Bags
Clothes Pins	Scouring Pads
Coloring Extracts	Silver Polish
Cough Drops	Soap and Detergent
Deodorizers (air fresheners)	Sponges
Dietary Supplements or Adjuncts	Starch – Laundry
Dishcloths	Straws
Dog Food	Table Covers – Paper
Drain Cleaners	Tile Cleaner
Dye – Clothes	Toilet Tissue
Facial Tissues	Toothpicks
Floor Wax and Applicators	Upholstery Cleaner
Fly Swatters	Water Softener (laundry)
Fuel – Cooking, Heating	Water Softener Salt
Furniture Polish	Wax Paper
Garbage Bags	Wax Remover
Glass Cleaner	Whisk Brooms
Ice	Wine
Insect Spray, Poison, Bombs	

**B. NONGROCERY TAXABLE ITEMS**

Examples of taxable items not regularly sold in grocery stores referred to as “nongrocery

taxable items” include the following:

Accessories – Auto	Gloves
Adhesive Tape	Hair Dye
Ammunition	Hair Styling Products
Antacid Liquids	Hardware
Appliances – Household, Auto	Medicated Cleansers
Auto Cleaner, Polish, Waxes	Medicine for Pets
Baby Oil	Notebooks
Batteries – Auto, Flash Light	Nursery Stock
Books	Pencils, Pens & Ink
Bubble Bath	Pet Litter
Cameras	Pet Supplies & Equipment (not food)
Chinaware	Pots & Pans
Cigarette Lighters	Powder (face or body)
Clothing	Rawhide Chew Bones
Cosmetics	Razors
Deodorizers (body)	Razor Blades
Diapers (cloth or disposable)	Rubber Bands
Dishes	School Supplies
Distilled Spirits	Scotch Tape
Drug Sundries	Shaving Cream & Lotion
Electrical Supplies	Shampoo & Rinse
Farm & Garden Implements	Shoe Laces & Polish
Fertilizers	Silverware
Film	Sporting Goods
Firearms	Stationary
Flashlights	Sun Glasses
Flower & Garden Seeds	Sun Tan Lotion and Sunscreen
Flowers	Thread
Fuel & Lubricants (includes diesel fuel, grease, etc.)	Tools
Furniture	Toothpaste
Garden Tools & Supplies	Toys
Glassware	