STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION
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EDMUND G. BROWN JR.
Governor

MARYBEL BATJER
Secretary, Government Operations Agency

NICOLAS MADUROS
Director

September 14, 2017

VIA INTERNET

Dear Interested Party:

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

The Business Tax and Fee Division is proposing to revise the following AM Chapters:

- Chapter 4, *General Audit Procedures*
- Chapter 5, *Penalties*
- Chapter 6, *Vehicle, Vessel and Aircraft Dealers*
- Chapter 8, *Bars and Restaurants*

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

If you have any comments or suggestions related to the proposed AM revisions, you may contact the CDTFA at AM.RevisionSuggestions@boe.ca.gov. Your comments or suggestions must be received by the CDTFA no later than **November 14, 2017,** in order to be considered by staff. Thank you for your consideration.

Sincerely,

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division

PURCHASES SUBJECT TO SALES OR USE TAX 0408.00

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AUDITS OF PURCHASES SUBJECT TO USE TAX
OUT OF STATE VEHICLE, VESSEL OR AIRCRAFT PURCHASE 0408.50

~~The~~A purchaser is generally liable for the use tax for a vehicle, vessel or aircraft purchased outside California if the first functional use of the vehicle, vessel or aircraft is in California. Revenue and Taxation Code section 6248 and Regulation 1620, *Interstate and Foreign Commerce*, subdivision (b)(5)(A), provide in part, that when a vehicle, vessel, or aircraft is purchased outside of California, is first functionally used outside of California and is brought into California within 12 months from the date of its purchase, it is rebuttably presumed to have been acquired for storage, use or other consumption in California and subject to use tax if *any* of the following occur:

~~The purchaser is liable for the use tax for a vehicle purchased outside California if the first functional use of the vehicle is in California. If the first functional use is outside California but the vehicle is brought into the state within the applicable test period, the purchaser may also be liable for the California use tax. The applicable test period is generally dependent upon the purchase date of the vehicle, as illustrated below:~~

~~Purchase Date~~	~~Test Period~~
~~Prior to October 2, 2004~~	~~90-Day Test*~~
~~October 2, 2004 – June 30, 2007~~	~~12-Month Test~~
~~July 1, 2007 – September 30, 2008~~	~~90-Day Test*~~
~~On or after October 1, 2008~~	~~12-Month Test~~

~~*The 90-day period is exclusive of any time for shipment or storage for shipment to California.~~

~~If the applicable test period is 90 days, the purchaser is liable for the use tax if during the six-month period immediately following the vehicle's entry into this state, one-half or more of the miles traveled by the vehicle are miles traveled in California or the vehicle is not used or stored outside California one-half or more of that time.~~

~~If the applicable test period is 12 months, the purchaser is liable for the use tax if any of the following occurs:~~

1. The vehicle, vessel, or aircraft was purchased by a California resident as defined in section 516 of the California Vehicle Code (a closely held corporation or limited liability company shall also be considered a California resident if 50 percent or more of the shares or membership interests are held by shareholders

or members who are California residents as defined in Section 516 of the Vehicle Code), or

2. In the case of a vehicle, tThe vehicle was subject to registration under Chapter 1 (commencing with section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership. or.

2.3. In the case of a vessel or aircraft, the vessel or aircraft was subject to property tax in this state during the first 12 months of ownership, or

3.4. If purchased by a nonresident of California, tThe vehicle, vessel, or aircraft is was used or stored in California more than one-half of the time during the first 12 months of ownership.

If any of these factors are present, the presumption will apply regardless of when the vehicle, vessel, or aircraft is brought into California during the first 12 months of ownership.

The first paragraph of Regulation 1620 subdivision (b)(5)(B) provides general guidelines for rebutting the presumption created by Regulation 1620 subdivision (b)(5)(A). It provides that the presumption may be rebutted by documentary evidence demonstrating that the vehicle, vessel, or aircraft was purchased for use outside of California during the first 12 months of ownership. Although the paragraph does not provide a bright line test with set parameters, it requires that all relevant evidence and facts be considered when determining whether the vehicle, vessel, or aircraft was purchased for use outside of California during the first 12 months of ownership. Evidence and facts that may be evaluated and considered include, but are not limited to:

- Whether the vehicle, vessel, or aircraft was previously registered with the proper authorities outside of this state;
- Whether the purchaser had a residence outside this state;
- How the vehicle, vessel, or aircraft was used during the first 12 months of ownership;
- The location that the vehicle, vessel, or aircraft was insured for;
- Whether the purchaser's move to California (if applicable) was voluntary or involuntary; and
- For documented vessels and aircraft, payment of property tax in another state.

If the evidence and facts demonstrate that, at the time of the purchase, it was more likely than not that the purchaser had no intention that the vehicle, vessel, or aircraft would be used in California, then this alone is sufficient to establish that it was purchased for use outside of California.

The facts and circumstances of each case should be evaluated and considered in their entirety when determining if a vehicle, vessel or aircraft was purchased for use outside of California during the first 12 months of ownership pursuant to the first paragraph of Regulation 1620, subdivision (b)(5)(B). For example, the fact that a purchaser voluntarily moves to California within 12 months of the purchase date does not automatically prevent the purchaser from overcoming the presumption. Instead, a voluntary move is a factor to consider, along with all of the other facts and circumstances, when determining whether a vehicle, vessel or aircraft was purchased

for use outside of California. On the other hand, an involuntary move based on circumstances that arose after the purchase date is strong evidence that the vehicle, vessel or aircraft was purchased for use outside the state.

If the evidence provided shows that a vehicle, vessel, or aircraft was purchased for use outside California, then a Certificate of Use Tax Clearance (CDTFA-111) should be issued.

In addition, the second paragraph of Regulation 1620 subdivision (b)(5)(B) and subdivisions (b)(5)(C) and (D) further explain how the presumption may be overcome in certain circumstances involving certain warranty or repair service, retrofits, modifications, and uses in interstate or foreign commerce.

APPROVAL OF EVASION PENALTIES 0509.75

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(No changes made to the other text in this section.)

Evidence Supporting Fraud

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RTC Section 6597, Penalty

RTC section 6597 imposes a 40 percent evasion penalty on any person who knowingly collects sales tax reimbursement or knowingly collects use tax, and fails to timely remit that sales tax reimbursement or use tax (tax) to the CDTFA. If recommending ~~RTC section 6597~~ the 40~~%~~ percent evasion penalty under RTC section 6597, ~~(tax reimbursement collectedand not timely remitted),~~ in addition to establishing, by clear and convincing evidence, the taxpayer's intent to evade tax, staff should state and explain how all conditions listed in AM section 0509.65 for applying the 40~~%~~percent penalty are met. The inclusion of a table of quarterly tax collected and tax reported to illustrate that the conditions listed in AM section 0509.65 are met is recommended.

Staff should also include the following information (if applicable) in the memorandum when recommending the 40 percent penalty:

- A description of the activity (including any unusual activity) in the taxpayer's tax accrual account that would indicate an intent to evade the tax.
- Detail of the debits/credits from the tax accrual account including dates and amounts.
- If the taxpayer does not maintain a tax accrual account, then an explanation from the taxpayer as to what happened to the tax collected is required.
- Any additional information obtained that supports the 40 percent penalty.

INTERSTATE DELIVERIES FROM CALIFORNIA STOCKS (Cont. 1) 0611.15

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~~The purchaser is liable for the use tax for a vehicle purchased outside California if the first functional use of the vehicle is in California. If the first functional use is outside California but the vehicle is brought into the state within the applicable test period, the purchaser may also be liable for the California use tax. The applicable test period is generally dependent upon the purchase date of the vehicle, as illustrated below:~~

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~~If the applicable test period is 90 days, the purchaser is liable for the use tax if during the six-month period immediately following the vehicle's entry into this state, one-half or more of the miles traveled by the vehicle are miles traveled in California or the vehicle is not used or stored outside California one-half or more of that time.~~

~~If the applicable test period is 12 months, the purchaser is liable for the use tax if any of the following occurs:~~

1. ~~The vehicle was purchased by a California resident.~~
2. ~~The vehicle was subject to registration under Chapter 1 (commencing with section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership.~~
3. ~~The vehicle is used or stored in California more than one-half of the time during the first 12 months of ownership.~~

RESTAURANT AUDITING 0809.00

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ALTERNATIVE REPORTING METHODS FOR TAXABLE FOOD SALES 0809.12

Certain taxpayers in the food and beverage industry may enter into an agreement with the California Department of Tax and Fee Administration (CDTFA) allowing the taxpayer to report certain taxable sales of food products on a percentage basis. This section provides guidance regarding the qualifications and procedures required for an agreement with the taxpayer to use an alternative reporting method.

The following are typical establishments that will qualify for reporting certain taxable food sales on a percentage basis:

- Coffee houses
- Sandwich shops
- Ice cream or yogurt shops
- Smoothie shops
- Donut shops
- Bakeries

Regulation 1603, *Taxable Sales of Food Products*, provides that tax applies to sales of food products when they are consumed at facilities provided by the retailer. Alternatively, cold food products, coffee, tea, and bakery items that are taken "to-go" are not subject to tax. Thus, taxpayers that provide dine-in facilities at their establishments may have difficulties accurately calculating their sales tax liability due to various uncontrollable factors, such as employees not asking whether a sale is for dine-in or take-out, key ring errors, or customers ordering "to-go" but dining at the facility.

Therefore, the alternative reporting method allows taxpayers to report certain taxable sales of food products by applying a predetermined percentage to their total sales of certain food products. This method allows taxpayers to charge the same price for a particular food product without regard to the dine-in or to-go intentions of their customers. The predetermined taxable percentage will be regarded as tax-included sales, only if the taxpayer includes in its receipts or posts printed material indicating, "*All prices of taxable items include sales tax reimbursement computed to the nearest mill.*" When a taxpayer is approved to report on an alternative reporting method, doing so satisfies the requirements of Regulation 1603(f).

The agreement to use an alternative reporting method does not apply to sales of items that are always taxable regardless of whether for consumption on the business premises or on a "to- go" basis. For example, the sale of hot prepared food items, food and drinks served in returnable containers, carbonated beverages, alcoholic beverages, or other tangible personal property is always subject to tax and should be

excluded in the percentage for the alternative reporting method. The taxpayer may choose to collect sales tax reimbursement on hot prepared food items and other tangible personal property, or to sell them at a tax-included price pursuant to Regulation 1700, *Reimbursement for Sales Tax*.

Requirements for an Alternative Reporting Method Agreement

To enter into an alternative reporting method agreement, the taxpayer must meet the following criteria:

- The account must have a prior audit, or be selected for and have an audit completed prior to the agreement.
- The account must have been active for three or more years.
- The account must have five or more active locations.
- All locations must be similar in scope and layout.
- All locations must provide dine-in facilities.
- Each location must report at least $250,000 of gross sales per quarter.
- The business does not meet the criteria to report tax based on the 80/80 rule.
- All sales of food and drinks whether for "dine-in" or "to-go" are sold in the same types of disposable containers. (All food and beverages sold with returnable containers and trays are not to be included in the calculation of the percentage).
- The taxpayer must maintain adequate books and records.
- The request must be made in writing.

Accounts not meeting **all** of the above criteria are not eligible to enter into an agreement. In addition, franchised establishments under a separate permit number will not be subject to the agreement of another franchisor.

Guidelines for Developing a Taxable Percentage

When a taxpayer wants to enter into an alternative reporting method agreement, audit staff should prepare a request to the Deputy Director, Field Operations Division (FOD), for approval prior to working on an agreement with the taxpayer. The request should demonstrate an adequate reason(s) that an alternative reporting method would better serve the taxpayer and the State than recording and reporting on an actual basis. For example, the taxpayer makes a statement that he makes every effort to collect sales tax reimbursement on dine-in sales, but his customers often dine at the facilities on "to-go" sales, leading to the under reporting of taxable sales.

Once the request is approved by the Deputy Director, FOD, audit staff may begin coordinating on-site observation tests to determine the taxable percentage to be used in the alternative reporting method. Prior to conducting the tests, the taxpayer must provide a list of all business locations to the audit staff. Only those locations that have been provided by the taxpayer will be allowed to report taxable sales at the agreed upon percentage resulting from the tests. The taxpayer is responsible for providing personnel to perform the in-store observation testing. CDTFA staff may participate in any or all testing solely at its discretion. The audit staff has discretion to determine which locations, dates, and times to be used for the observation tests.

The requirements for the observation test are as follows:

- The tests should include a minimum of five locations, which must be representative of the entire business.
- A minimum number of testing hours should be established based on three full days of operation and distributed between the locations tested. A full day is considered all hours that the business is open. If the business is open from 6:00 a.m. to 10:00 p.m., then 16 hours is one full day for testing purposes. In this case, the minimum hours of observation testing would be 48 hours (3 days X 16 hours) distributed between the locations tested.
- All tested locations must sell the same type of products, have a similar layout, and maintain similar hours of operation.
- Test results for each location are to be documented and provided to the taxpayer.
- The taxpayer or their representative must sign a copy of the test results for each location.

The results from the observation tests must be documented in a written agreement and signed by the taxpayer or their representative. Audit staff will forward the signed written agreement, along with the results from the observation tests, to the Deputy Director, FOD, for approval and signature. If approved, the original document should be maintained at the field office and the audit staff must forward a copy of the approved agreement to the taxpayer or their representative and the Taxpayer Records Unit (MIC: 36).

The taxable percentage established in the observation test must be implemented by the start of the next reporting period. For example, the audit staff determined that a taxpayer's sales of coffee, bakery items, and cold food products were consumed on the premises 25 percent of the time, and entered into an agreement in February 2017. If reporting on a quarterly reporting basis, the taxpayer is required to report based on this agreed percentage beginning with the second quarter of 2017.

Conditions to the Agreement

As part of the written agreement, the taxpayer must agree to the following:

- Maintain adequate accounting records pursuant to Regulation 1698, *Records*.
- Provide books and records for examination within 30 days upon request by CDTFA staff.
- Provide the resources necessary to assist the CDTFA in determining a taxable percentage.
- Post a clearly visible notice at each business location subject to the agreement stating that "All prices of taxable items include sales tax reimbursement computed to the nearest mill."
- Provide the CDTFA with a 90-day advance written notice to cancel the agreement.
- Use the agreed percentage for reporting until notified in writing by the CDTFA of any amendments or cancellation of the agreement.

All written agreements should clearly state the following:

- All sub-locations subject to the agreement.
- The period for which the agreement applies.
- The agreed upon percentage the taxpayer will report for certain taxable sales of food products.

In most cases, the agreement will be valid for up to three years, or until the audit staff notifies the taxpayer or their representative in writing that the agreement is no longer valid. When businesses holding such agreements add new sub-locations to their permit, transactions from those locations are not to be included in the agreement without written approval from the audit staff. The audit staff may, at their discretion, allow sales from a new sub-location to be reported at the agreed percentage as long as the new business location is similar in operation, types of products sold, store hours, scope, and layout. If deemed necessary, the audit staff may conduct further observation tests for the new location, and include the results of the additional tests to amend the agreement in effect.