

UNDERSTANDING CALIFORNIA'S SALES AND USE TAX LAWS
(or one Senior Auditor's Interpretation to one alpaca owner)
By Joyce Judy
Alpacas del Oeste

CA SALES AND USE TAX - INTRODUCTION
Bonnie Potter
Fair Winds Alpacas

A Senior Tax Auditor from the California Board of Equalization presented an overview on California Sales and Use Tax at the California Classic in April. Since many of us were confused about these taxes, and concerned about the implications to the alpaca industry in California, the Calpaca Board of Directors put together a Sales and Use Tax Committee co-chaired by Sandra Wallace and Joyce Judy to further study the issue and make recommendations. The Committee did an outstanding job of researching the issue and they compiled a vast amount of detailed information which I have reviewed on behalf of the Calpaca Board. The following information paper was prepared by Joyce Judy to assist us in understanding the current application of Sales and Use Tax in California. The information was so well presented that the Board decided to post it for the entire membership. The regulations regarding what constitutes *Use* are quite vague and the circumstances in which Use Tax may be owed are subject to interpretation. The questions posed in writing to this particular Senior Tax Auditor differ from what we heard from the Senior Tax Auditor at the Classic. As noted in the Information Paper, the answers to the questions represent the opinion of one auditor, and "written advice may only be relied upon by the taxpayer to which it was originally issued".

I recently learned that one taxpayer engaged in the business of buying, breeding and selling horses appealed the application of *Use Tax* to mares being bred while being held for resale. The court found "that the taxpayer's depreciation of the mares on its federal and state income tax returns evidenced an intent to use the animals ... and further found that resale inventory is not ordinarily subject to a depreciation allowance as a capital asset for income tax purposes. Accordingly, the court upheld the use tax." (Per IRS Publication 225, Farmer's Tax Guide, Livestock purchased for draft, breeding, or dairy purposes can be depreciated only if they are not kept in an inventory account). You should consult with your tax adviser to be sure you are properly handling Assets vs. Inventory held for resale

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The Calpaca Sales and Use Tax Committee has spent many months researching the California Sales and Use Tax laws. I thought that I was the person with the least to lose, so I started a series of email questions and answers with a Senior Auditor at the Board of Equalization. Those questions and answers are provided below. You should know that other tax auditors have given different responses to these same questions.

I am NOT a Sales and Use Tax expert. I recommend that you verify the information provided here with the Board of Equalization **as it relates to your own circumstances** (<http://www.boe.ca.gov/>) and **your own tax advisor**. No information provided here should be construed as being legal or tax advice.

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[Note: Items that are in **red** quotation marks or **typed in red** are direct quotes from the Board of Equalization.]

In fact, the BOE says in their Audit Manual (<http://www.boe.ca.gov/pdf/fam-01.pdf>)

“SECTION 6596 GUIDELINES FOR TAXPAYER CORRESPONDENCE 0101.75

ADVICE PROVIDED IN A WRITTEN COMMUNICATION.

Written advice by the Board to a taxpayer in response to a taxpayer's specific written inquiry or from his or her representative seeking relief from liability will constitute written advice that can be relied on for section 6596. To be considered a specific written inquiry, representatives must identify the specific taxpayer for whom the advice is requested. Such an inquiry must also fully describe the specific facts and circumstances of the activity or transactions for which the advice was requested.

In responding to accountants, attorneys, or other taxpayer representatives where the name of the taxpayer is not divulged, the writer will ask that the representative divulge the name and permit number of the taxpayer to enable the Board to maintain appropriate records with respect to the information provided. The taxpayer's name and permit number will be referenced in the Board's response.

Tax advice to trade associations, taxpayer representatives failing to identify their clients, and/or taxpayers whose questions are vague or general in nature must include the following statement:

The answer given is intended to provide general information regarding the application of the tax and will not serve as a basis for relief of liability under section 6596.

If individual taxpayers are identified, but background information is incomplete, the taxpayer should be encouraged to write again setting forth the specific facts. Staff is encouraged **not** to make presumptions. However, should it become necessary to do so, they should be clearly identified as such in the letter.

Written advice may only be relied upon by the taxpayer to which it was originally issued or a legal or statutory successor to that taxpayer. Written advice that may serve for relief under section 6596 must include the following statement:

*The opinion expressed in this letter may only be relied upon for relief under section 6596 of the Sales and Use Tax Law by (state taxpayer's name). **If you provide this letter to your customers or vendors, those customers or vendors must write to the Board and obtain their own written opinion in order for them to qualify for relief under section 6596. Any person seeking relief under this section will be required to furnish a copy of their own original written inquiry to the Board along with a copy of the written response they received from the Board.***

Q1. Define sales and use tax and who owes them?

A1. “Retailers engaged in business in California must register with the BOE and pay the state's sales tax, which applies to all retail sales of goods and merchandise except those sales specifically exempted by law. The use tax generally applies to the storage, use, or other consumption in California of goods purchased from retailers in transactions not subject to the sales tax. Use tax may also apply to purchases shipped to a California consumer from another state, including purchases made by mail order, telephone, or Internet.”

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"The sales and use tax rate in a specific California location has three parts: the state tax rate, the local tax rate, and any district tax rate that may be in effect."

"You must obtain a seller's permit if you:

- Are engaged in business in California
- Intend to sell or lease tangible personal property that would ordinarily be subject to sales tax if sold at retail."

Q2. What constitutes "tangible personal property?"

A2. "Tangible Personal Property is defined as personal property that may be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses."

Q3. Are alpacas exempt from sales and use tax?

A3. The answer is generally NO. However, there are exceptions. The BOE states: *Regulation 1587, "Animal Life, Feed, Drugs, and Medicines," explains tax does not apply to sales of any form of animal life of a kind **the products of which ordinarily constitute food for human consumption** (food animals), as for example, cattle, sheep, swine, baby chicks, hatching eggs, fish, and bees. Operative January 1, 1993, food animals include ostriches. Operative January 1, 1996, food animals include emus. Operative January 1, 2000, the term "food animals" includes any form of animal life classified by the California Department of Food and Agriculture, by regulation, as livestock or poultry intended for human consumption under sections 18848 and 25408 of the California Food and Agricultural Code. Tax shall not apply to sales of such newly defined food animals on or after the date the related California Food and Agricultural regulation is effective."*

Q4. If I sell my alpaca to a person who has a seller's permit, is sales tax owed by my farm/ranch?

A4. In order for your farm/ranch to be exempt from owing sales tax, the buyer who has a Seller's Permit **must** issue you a Resale Certificate. This form can be found on the BOE website at <http://www.boe.ca.gov/pdf/boe230.pdf>. "You must obtain a timely **resale certificate** that is dated and includes required elements such as the seller's permit number, the name, address, and signature of the purchaser, and a description of the property purchased with a statement that the property purchased is for resale. **A copy of a seller's permit alone does not contain these elements.**"

Note: By accepting a Resale Certificate, the Seller is not required to pay sales tax; however, the Buyer is now saying that they are purchasing the alpaca for sale "in the regular course of their business."

Q5. If I buy an alpaca from a seller and provide that seller with a resale certificate would either the seller or I owe sales tax if my "intent" is to resell the alpaca?

A5. "You can purchase the alpacas for resell as long as you will be selling the alpacas in the regular course of your business."

Q6. If I place that alpaca up for sale on a website, but the animal doesn't sell right away, I must shear it for its health and I must breed it to prove it is able to breed, so I wouldn't owe Use Tax, correct?

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- A6.** "As long as the alpaca is being held for sale in the regular course of business even though you may have used it for breeding purposes, you would not owe use tax. The breeding purposes would not constitute taxable use of the animal, nor would shearing of the animal."
- Q7.** **As long as I have that alpaca for sale, how long a period needs to pass before BOE would determine that my "intent" is not to resell the alpaca?**
- A7.** "As long as the alpaca is held for sale in the regular course of your business, there is not a specified time frame which we would determine that you are not intending on selling the alpaca. **However, you should document that the alpaca is being held for sale in your business by keeping records such as newspaper or website ads.**"
- Q8.** **If an alpaca I purchase with a resale certificate is pregnant and has a baby before I resell it, would I owe use tax simply because the alpaca had a baby?**
- A8.** No, you would not owe use tax on the cost of an alpaca that has a baby.
- Q9.** **If I purchase an alpaca in Oregon (a non-sales tax state) and it is delivered to me in California and I put it up for sale on my website, do I owe use tax?**
- A9.** "If you have a California Seller's Permit and sell the item prior to making any use of it **[Note: See Q5 above regarding intent to sell and Q6 regarding use while attempting to sell]**, the purchase would qualify as an exempt sale for resale. Please refer to Publication 103, Sales for Resale, for additional information on the requirements for this exemption:
<http://www.boe.ca.gov/pdf/pub103.pdf>"

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Q10. If I sell an alpaca to someone in Oregon (a non-sales tax state) or another state and they take possession of the alpaca in Oregon or the other state does anyone owe sales or use tax?

A10. "Your sale is not subject to California sales tax if you:

- Ship the product directly to the purchaser, using your own delivery vehicle or another means of transport that you own, to a destination outside of California for use outside this state; **or**
- Ship the product by delivering it to a common carrier (including the US Postal Service), contract carrier, customs broker, export packer, or forwarding agent, to a destination outside of California for use outside this state;

Note: In most cases, if a purchaser or their representative takes possession of an item in California - even temporarily - your sale does not qualify for this particular sales tax exemption.

For additional information concerning **exempt out of state sales** please refer to Publication 101, Sales Delivered Outside of California, available on our website at: <http://www.boe.ca.gov/pdf/pub101.pdf>"

Q11. I give away inventory items to promote my business. If the selling price is zero, is there any tax due?

A11. When you purchase inventory, you do so without tax because it is expected that you will resell the items. Giving away inventory is considered a use of the property and is subject to tax based on your cost. Examples include inventory used for testing, promotional giveaways, and donations.

Q12. If I donate an alpaca (that I have held for resale) to a non-profit organization and that alpaca will be auctioned off with proceeds going to a scholarship fund at a university for large animal vet students will I owe either sales or use tax? If so, would that be based upon the auction price or my estimated value prior to sale?

A12. "I contacted you on September 14, 2006 to receive additional clarification to your e-mail. You stated that the donor takes the alpaca out of resale inventory and donates it to an auction who you believed is a qualified organization as stated in Regulation 1669. You were asking if the donor would owe use tax if the alpaca was donated to a qualified organization.

Regulation 1669, "Demonstration, Display and Use of Property Held for Resale-General," subdivision (e) states:

(1) IN GENERAL. Operative January 1, 1989, use tax does not apply to tangible personal property withdrawn from a resale inventory for the purpose of making a charitable contribution to a qualified organization located in this state. This exemption applies only to property which has been purchased for resale and subsequently donated without any use other than retention, demonstration or display while holding it for sale in the regular course of business. For purposes of this regulation, property purchased for the purpose of incorporation into a manufactured article is regarded as having been purchased for resale. For the period January 1, 1989 through October 1, 1989, this exemption is

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available only to retailers. Effective October 2, 1989, this exemption is available to all sellers. Property purchased specifically for donation to a qualified organization remains subject to the tax. As provided in section 6094.5 of the Revenue and Taxation Code, a person is guilty of a misdemeanor if a resale certificate is issued for property which he or she knows at the time of purchase will be donated rather than resold. Such improper use of a certificate may cause the person to become liable for penalties called for by Sections 6072, 6094.5, 6484 or 6485 of the Revenue and Taxation Code.

(2) "QUALIFIED ORGANIZATION". For purposes of this regulation, "qualified organization" means and includes any organization described in Section 170(b)(1)(A) of the Internal Revenue Code including but not limited to:

(A) Religious organizations, e.g., synagogues, churches and associations of churches;

(B) Charitable organizations, e.g., the Red Cross, the Salvation Army, nonprofit schools and hospitals, and medical assistance and research groups;

(C) Organizations operated for educational, scientific, or literary purposes including nonprofit museums, art galleries, and performing arts groups;

(D) Organizations operated for the protection of children or animals;

(E) Fraternal lodges if the donated property is to be used for charitable purposes and not for the benefit of the members; and

(F) The United States, this state and any political subdivision of this state."

"To answer your question, if the alpaca is withdrawn from resale inventory and is donated to a qualified organization, the donor will not owe use tax on the alpaca. Conversely, if the alpaca is donated to an entity which is not a qualified organization, use tax would likely apply."

Q13. Will the buyer of the alpaca owe sales tax on the purchase of the alpaca, even though the proceeds are going to a scholarship fund? What if the buyer of the alpaca "intends" to hold the alpaca for resale and issues a resale certificate? If they issue the resale certificate, then it would be to the seller, who would in turn, donate the proceeds to the non-profit organization, correct?

A13. Regulation 1565, "Auctioneers," states persons engaged in the business of making retail sales at auction of tangible personal property owned by such person or others are retailers, and are, therefore, required to hold sellers' permits and pay tax measured by the gross receipts from such sales.

Regulation 1668, "Sales for Resale", subdivision (a), states the burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a certificate from the purchaser that the property is purchased for resale. If timely taken in proper form as set forth in subdivision (b) and in good faith from a person who is engaged in the business of selling tangible personal property and who holds a California seller's permit as required by Regulation 1699, "Permits," the certificate relieves the seller from liability for the sales tax and the duty of collecting the use tax. A certificate will be considered timely if it is taken at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment

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cycle, or any time at or prior to delivery of the property to the purchaser. A resale certificate remains in effect until revoked in writing.

I contacted you on September 14, 2006 to receive additional clarification to your e-mail. You stated you will donate an alpaca to an auction. The auction was a non-profit organization. The auction will then sell the alpaca to a buyer. I am assuming the non-profit organization has a seller's permit whose sales are generally subject to tax unless exempt such as interstate commerce or resale.

In your e-mail, you were asking if the buyer would owe sales tax to the auction when purchasing the alpaca at the auction even though the auctions' gross receipts are going to a scholarship fund. Also, you were asking if the buyer was purchasing the alpacas for resale, would the buyer still owe sales tax.

To answer your question, generally sales by a retailer in California are subject to tax unless exempt such as a sale for resale or interstate commerce. If the sale by the auctioneer was subject to tax, the auctioneer can seek reimbursement from the buyer and the buyer would be liable for sale tax to the auction even though the auctioneer's gross receipts are going to a scholarship fund. Also, if the buyer is purchasing the alpacas for resale, the buyer can issue a resale certificate to the auctioneer and purchase the alpacas without sales tax as long as the buyer will be selling the alpacas in the regular course of their business. When the buyer issues a valid resale certificate to the retailer, this relieves the seller from liability for the sales tax.

- Q14.** My business is located in Fresno. However, we regularly deliver newly purchased alpacas to customers located in Contra Costa County. Which tax rate applies?
- A14.** The Contra Costa County tax rate applies and you are responsible for collecting the tax based upon the rate in Contra Costa County. However, if the customer picks up the merchandise in Fresno, then the Fresno tax rate applies. **[Note: This assumes the customer does not provide a Resale Certificate.]**