



# Tax Information Bulletin

STATE BOARD  
OF EQUALIZATION

ISSUED QUARTERLY  
June 2000

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### Just What the Doctor Ordered?

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### Application of Tax to Dot.com Sales

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See article 5 for a correction to last March's article on the printing industry.

### Advertisers and Graphic Artists

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## 1. New Tax Rates Take Effect for Mariposa County and the City of Woodland on July 1, 2000

The following new sales and use tax rates will take effect on July 1, 2000:

### Mariposa County: 7.75 percent

Voters have approved a 0.50 percent Mariposa County Healthcare Authority (MCHA) district tax, which will increase the tax rate from 7.25 percent to 7.75 percent. The district tax applies to the entire county.

### City of Woodland: 7.75 percent

Voters have approved a City of Woodland General Revenue Transactions and Use Tax (WOGT), which will increase the tax rate within the city limits of Woodland from 7.25 percent to 7.75 percent.

*Note:* Woodland is located in Yolo County. The tax rate in areas of the county outside the city limits of Woodland will remain at 7.25 percent.

### Which retailers must collect tax at the new rate?

You must apply the new 7.75 percent rate if you

- Are a retailer in the district and your merchandise is sold and delivered within the district.
- Are a retailer located outside of the district who is engaged in business in the district and you sell merchandise for use in the district. You are considered to be engaged in business in the district if you (1) have any type of business location there, (2) deliver into the district using your own vehicles, or (3) have an agent or representative in the district for the purpose of taking orders, delivery, installing, selling, or assembling.
- Are a dealer of vehicles, vessels, or aircraft and sell those items to persons who will register or license them to an address located in the district.
- Collect tax on lease payments you receive for leased property used by the lessee in the district.



### *Is there an exemption from the tax rate increase?*

In general, fixed-price contracts and fixed-price lease agreements entered into prior to July 1, 2000, are subject to the tax rates in effect at the time you and your customer entered into the contract. To qualify as "fixed-price," neither party can have the unconditional right to adjust the price for an increase in costs or terminate the contract or lease [Revenue and Taxation Code sections 7261(g) or 7262 (f)]. In addition, the tax amount or rate must be specifically stated in the contract or lease agreement. If the contract or lease qualifies as fixed-price, you should continue to report and remit the specified tax rate — that is, the rate in effect at the time you entered into the contract.

## **2. Regulation 1591, Medicines and Medical Devices, Expanded and Reorganized into Five Regulations**

Regulation 1591 was recently reorganized into five separate regulations to clarify and segregate the regulation by subject matter. The regulations are as follows:

- 1591, *Medicines and Medical Devices*
- 1591.1, *Specific Medical Devices, Appliances, and Related Supplies*
- 1591.2, *Wheelchairs, Crutches, Canes, and Walkers*
- 1591.3, *Vehicles for Physically Handicapped Persons*
- 1591.4, *Medical Oxygen Delivery Systems*

In addition to being reorganized, the five regulations provide expanded definitions and listings of the types of items that qualify as medicines and clarify whether their sale or use is taxable. Through clarification, some provisions have been reinterpreted, resulting in a change in the application of tax. One of the more significant changes affects the application of tax to insulin test strips and lancets, as described below.

### ***Insulin, Insulin Syringes, and Related Supplies Used by Diabetic Patients***

Other than glucose test strips and skin puncture lancets furnished and used as discussed below, tax applies to the sale or use of test kits

and equipment used to analyze, monitor, or test samples of cells, tissues, organs and blood, saliva, or other bodily fluids. Tax also applies to the sale or use of diagnostic substances applied to samples of cells, tissues, organs, or bodily fluids and waste after such samples have been removed, withdrawn, or eliminated from the human body.

*Test strips and lancets.* As provided by Regulation 1591.1(b)(5), tax does not apply to the sale or use of insulin and insulin syringes, glucose test strips, or skin puncture lancets furnished by a pharmacist, as directed by a physician, to a diabetic patient for the patient's use in treating diabetes. To qualify for this exemption from tax, glucose test strips and skin puncture lancets *must* be furnished by a pharmacist for the patient's *own use* in determining his or her blood sugar level. The use of glucose test strips or skin puncture lancets by a person other than the diabetic patient or the furnishing of such items by other than pharmacist is subject to tax. This is true even if furnished by a health facility or administered by hospital personnel.

For more information on the changes made to Regulation 1591 or copies of the respective regulations, please call our Information Center. Copies can also be downloaded from our website, [www.boe.ca.gov](http://www.boe.ca.gov).

## **3. You Can Now Use the Internet to Charge Tax Return Payments**

We now offer two ways to make sales and use tax return payments using a Discover/Novus, MasterCard, or American Express credit card. You can continue to make your payments by calling 1-888-2PAY-TAX (1-888-272-9829), or you can now make a payment over the Internet.

### **How To Charge a Payment on the Internet**

Go to [www.boe.ca.gov](http://www.boe.ca.gov) and click on "Electronic Services ." When you enter the area for making a payment, you will be asked to provide the following information:

- Payment type
- Tax amount
- Penalty amount, if any



- Interest amount, if any
- Tax period ending date
- Your seller’s permit number
- Your daytime phone number
- The zip code for the address where your credit card bills are mailed

For quicker access to BOE’s system menu, you can enter the Board’s jurisdiction code (1599) at the prompt.

After making your payment, check the box on your return indicating you have paid with your credit card. **Be sure to sign and mail your return.**

You will be charged a convenience fee by the credit card processing vendor (see table below).

Convenience Fee Rates

<i>Amount Charged</i>	<i>Fee</i>	<i>Amount Charged</i>	<i>Fee</i>
\$ 1-99.99	\$ 3	\$2700-3499.99	\$ 87
\$ 100-199.99	\$ 6	\$3500-4399.99	\$ 109
\$ 200-399.99	\$ 11	\$4400-5399.99	\$ 133
\$ 400-599.99	\$ 16	\$5400-6399.99	\$ 159
\$ 600-799.99	\$ 21	\$6400-7399.99	\$ 187
\$ 800-999.99	\$ 25	\$7400-8699.99	\$ 218
\$1000-1399.99	\$ 35	\$8700-10399.99	\$ 262
\$1400-1999.99	\$ 49	\$ 10400 +	\$ *
\$2000-2699.99	\$ 68		

\*The fee rates are shown at our website.

This fee is *not* revenue for the Board.

Your credit card transaction information is received on a daily basis from the vendor and immediately applied to your account.

*Notes*

- As explained on our website, you cannot pay by credit card if you are required to make payments by EFT (electronic funds transfer). Nor can you charge payments related to tax billings.
- If you experience difficulty making a payment by credit card — especially on the payment due date, you should send a check with your return or prepayment form to ensure you have made a timely payment.

To learn more about the credit card program, visit the Board’s website at [www.boe.ca.gov](http://www.boe.ca.gov) or contact our Information Center at 1-800-400-7115.

#### 4. Internet Sales and Purchases

There is a common misunderstanding that Internet sales are not subject to sales or use tax. In fact, tax applies to Internet sales no differently than to sales by other retailers. This article briefly discusses Internet sales, how tax applies to these sales, and whose responsibility it is to report and pay any tax that is due.

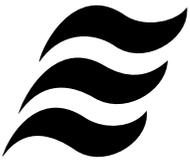
Internet sellers provide both services and goods. Generally, charges for sales of services are taxable only if the services are provided as part of a sale of goods. Charges for sales of goods are taxable when

- The item received is tangible personal property, and
- The storage, use, or consumption of the item first occurs in California.

A transfer solely via modem, such as the download of software, music, or pictures, is not considered a sale of tangible personal property and the charges for such purchases are not taxable, provided there is no transfer of tangible personal property — such as storage media (even if that transfer is “just in case”). In contrast, if you receive the same software, music, or picture on a diskette or CD, or you purchase a book, supply items, or clothing over the Internet for use in California, tax applies to the purchase price of these items.

Whether the Internet seller or its customer is responsible for reporting and paying tax on Internet sales depends on the location and status of the Internet seller:

- **Internet seller is physically located in the state.** The seller is a California retailer and must register with the Board of Equalization (Board) and must pay sales tax or collect use tax on taxable sales to customers in California.
- **Internet seller is not physically located in the state, but is engaged in business in the state (for example, the seller has an agent or representative in California who makes sales and takes orders).** The seller is a California retailer and must register with the Board and collect tax on taxable sales to California customers.



- *Internet seller is neither physically located in the state nor engaged in business in the state.* The seller is not a California retailer, and the customer in California is responsible for paying use tax directly to the Board.

If you have purchased goods on the Internet from someone other than a California retailer and you have not been taxed, then you must report the tax to the Board using one of two methods. If you hold a California seller's permit, you should report the cost of the items purchased on line 2 of your next regularly filed sales and use tax return. If you do not hold a seller's permit, you must report the tax directly to the Board. You may use either the Individual Use Tax Return found in the Board's publication 79-B *California Individual Use Tax*, or you may submit a letter to the Board describing the item purchased, the purchase price, and a check or money order for the amount of tax due.

Whichever reporting method is used, you must report tax at the rate in effect at the location where you first stored, used, or consumed the property. For example, goods used in Orange County must be reported at the tax rate of 7.75 percent. If you have questions about the proper rate of tax, reporting methods, or would like a copy of publication 79-B, please contact our Information Center. The form can also be downloaded from our website, [www.boe.ca.gov](http://www.boe.ca.gov).

## 5. Correction: Printing Industry Article

In the March 2000 *Tax Information Bulletin*, we included an article that explained the recent revisions to sales and use tax regulation 1541, *Printing and Related Arts*. Unfortunately, an error occurred in the second paragraph of the Composed Type section and a portion of the last sentence was deleted. The last sentence of the second paragraph should read: "Clip art" is defined as commercially available prepackaged, electronic art (including stock photographic images) that is not produced *to the special order of the customer*.

We apologize for any confusion our error may have caused and recommend that you note the appropriate change on your copy of the March article.

## 6. Tax Reporting for Advertising Agencies and Graphic Artists Is Simplified

If you are a graphic artist or you operate an advertising agency, reporting sales or use tax has just become easier. In cooperation with representatives from the advertising and graphic arts industries, Regulation 1540, *Advertising Agencies, Commercial Artists and Designers*, has been significantly amended. The regulation now

- Recognizes that graphic artists and advertising agencies make substantial use of computers and the Internet to create and transfer their products;
- Recognizes that advertising agencies and graphic artists primarily provide services to their clients;
- Presumes that advertising agencies act as agents of their clients, except for property produced by the employees of the agency;
- Allows graphic artists who bill lump sum for preliminary art or other concept development services together with the finished art to claim that 75 percent of that charge is for nontaxable services; and
- Limits the taxability of charges for reproduction rights for artwork or photographs to the proceeds contracted for and received within one year of the original transfer.

The following paragraphs discuss these provisions and how they apply to you and your business. Please note that if you operate an advertising agency that provides commercial artwork, the information about graphic artists also applies to you.

### ■ *Electronic or Digital Artwork*

Representatives of the advertising and graphic arts industries stressed that computers and the Internet have changed the business environment. The amended regulation reflects this change in technology. It defines electronic or digital artwork and provides guidelines on when tax applies to the transfer of such artwork.

Any image or layout you create on a computer, including photographs, is electronic or digital artwork and your charges for the artwork are



taxable only if you transfer something tangible to your client, such as a diskette, a CD, or a hard copy. However, transfer of the artwork *solely* via e-mail or downloaded from your website does not result in a transfer of anything tangible and your charges would not be taxable. Similarly, personally downloading the file onto your client's computer would not be a transfer of tangible personal property. To document that you have transferred a file in a nontaxable manner, particularly if you have downloaded the file on your client's computer, the regulation advises that the transfer be documented either through a statement on the invoice or in some other manner.

### ■ *Service Industry*

The amended regulation recognizes that advertising agencies and graphic artists are primarily in the business of providing services, not being retailers, and adopted two major changes. First, it creates the presumption that advertising agencies are generally agents of their clients. Second, it notes that graphic artists create and develop ideas, looks, and concepts for their clients.

#### *Presumption of Agency Status*

As an advertising agency, you are now presumed to be primarily providing services to your client, including acquiring tangible personal property on the client's behalf, unless (1) the product you provide has been fabricated by your employees, (2) your contract or invoice states that you are not acting as your client's agent, or (3) you contract to make a lump-sum sale of tangible personal property to your client.

For example, you contract with your client to provide printed advertising materials for a new product. The deliverables include countertop displays, posters, and flyers. All products are delivered to your customer in California and your itemized charge for all services, agency fees, and deliverables associated with the job totals \$25,000. If all products are fabricated by a third-party vendor, you may acquire them as an agent of your client by simply paying tax to the vendor on your cost and passing the products on to your client. No other documentation is required. Charges to your client in excess of the amount paid to the vendor are considered nontaxable fees.

If you wish to be a retailer of the products, you can either specifically contract to furnish certain products to the client for a lump-sum amount, or you can note on your invoice that you are not acting as the client's agent, but rather as a retailer to your client.

#### *Concept Development/Preliminary Art Services*

For graphic artists who transfer their artwork in tangible form, the amended regulation accepts that graphic artists create and develop ideas, looks, and concepts for their clients and that these services may constitute most of the time spent on a job. Industry representatives also explained that digital creation of artwork makes it difficult to determine when the conceptual services are finished and the creation of the final art begins. In consideration of these difficulties, the amended regulation allows graphic artists to claim 75 percent of their total lump-sum charges for commercial artwork as nontaxable services (provided the artist does not specifically transfer title or permanent possession of the preliminary art — see *Note* below). If you feel that your creative services are greater than 75 percent of the total billing, you may claim the higher percentage as long as you can support it through appropriate documentation, such as contracts.

For example, you agree to design a label for your client's product for a total charge of \$10,000. The final design is transferred to the client on a diskette. If you bill your client a lump-sum of \$10,000 at the conclusion of the job, you may claim \$7,500 as nontaxable services and pay tax only on \$2,500. If you use progress billings, you may still claim the 75 percent exemption as long as you calculate it based on your total billings. To support the claimed deduction, you need only keep records supporting the total charges billed.

*Note:* Another issue raised by the graphic arts industry was tax imposed on preliminary art transferred to clients for purposes of review. These transfers frequently were taxed because the graphic artists had no record that the preliminary art was returned by the client. To clarify this issue, the amended regulation provides that charges for preliminary art are not



taxable unless the artist has a contract of sale that passes to the client title to or the right of permanent possession of the electronic media or hard copy embodying the preliminary art.

#### ■ **Reproduction Rights**

Finally, the amended regulation now specifically states that the charges for the transfer in tangible form of artwork for reproduction (for example, on a diskette, CD or a hard-copy) are subject to tax, even though there is no transfer of title to the person doing the reproduction. However, to limit the taxability of these types of transfers, the amended regulation now provides that tax does not apply to the sale of additional licenses or copyrights or to the receipt of royalties by the original transferor that occur more than one year from the date of original transfer.

For example, you contract with a client to provide a magazine illustration, which you transfer to the client on a diskette. The client has the right to reproduce the illustration for an article in the current issue of the magazine for a charge of \$1,500. The contract also provides that the client may use the illustration for any reprints of the article for a charge of \$500. Two years after the initial publication of the article, the client decides to reprint the article and pays you \$500. You must report the \$1,500 as taxable; the \$500 is nontaxable.

#### ■ **Other Changes**

The amended regulation also

- Conforms to the provisions in Regulation 1541, *Printing and Related Arts*, with respect to sales of special printing aids and electronic/digital pre-press instructions.
- Provides that charges for single copies of blueprints, diagrams, and instructions resulting from environmental graphic design (for example, a diagram of where exit signs should be placed) are not taxable.
- Explains that charges for designing, editing or hosting a website are not taxable as long as no tangible property is transferred to the customer.

## **7. If You Pay Special Taxes or Fees, You Can Now Pay by Electronic Funds Transfer (EFT)**

It is now possible to make payments for special tax and fee programs by EFT, rather than through the use of paper checks. Until recently, only sales tax permit holders could use this payment method. To participate, you must complete an authorization agreement form for *each* special tax or fee account you wish to register for EFT. Your request to participate is subject to Board approval.

Once you are registered, you can make prepayments, return payments, and accounts receivable payments electronically. Even though you pay by EFT, *you must continue to file your tax or fee return forms on time.*

For more information, please contact the division that administers your particular program (see below). They will send you information about payment method options and payment instructions. The information packet also includes the required authorization agreement form.

You can contact us by e-mail through the BOE website at [www.boe.ca.gov](http://www.boe.ca.gov), or call us between 8 a.m. and 5 p.m. Pacific time on weekdays at one of the following numbers:

Environmental Fees	(916) 322-9534
Excise Taxes	(916) 327-4208
Fuel Taxes	(916) 322-9669

## **8. New Exemption for Sales of Containers Used to Ship Food Products**

Beginning April 1, 2000, if you sell or lease empty containers to customers who will use the containers to ship food products for human consumption, the sale or lease of the containers is not subject to tax, provided the food products will ultimately be sold.

It does not matter whether the food products are sold in the same container or not, or whether the food products are remanufactured or repackaged prior to sale. The exemption also applies whether or not the container is returnable.

The change is the result of the passage of Senate Bill 1210, which added subdivision (d) to



section 6364 of the Revenue and Taxation Code. The bill eliminates the need for the container to be sold with the food products, expanding the container exemption to cover leases of such qualifying containers.

The exemption is limited to containers used for shipping food products. For example, bins used solely for storage and not for shipment of food products do not qualify for the exemption.

Please call our Information Center if you have questions regarding this recent legislation.

## 9. Unpaid Tax Liabilities and the Offers-in-Compromise Program

*The following article applies only to businesses with inactive accounts with the Board.* — Editor

We are pleased to announce that the Board has created a new Offers in Compromise (OIC) Section in Sacramento. The new section has been formed to centralize and expedite the processing of such offers.

### What is an offer in compromise?

An offer in compromise is an offer to pay less than the full amount of a tax or fee liability that remains unpaid after a business has closed.

You can make such an offer if you

- No longer have an active account with the Board,
- Cannot pay the full amount of a tax or fee liability in a reasonable time, and
- Do not dispute the amount of the tax or fee liability.

### How do I apply?

You must complete an *Offer In Compromise Application* (Form BOE-490). Submit your application, along with supporting documentation, to the local district office that handled your account. That office will forward your request to Sacramento for evaluation.

You can obtain a copy of the form

- **From the Internet.** Visit [www.boe.ca.gov/pdf/490.pdf](http://www.boe.ca.gov/pdf/490.pdf).
- **By FAX.** Call 1-800-400-7115 and choose the fax-back option.
- **By mail.** Call 1-800-400-7115 during working hours to speak to a representative.

The OIC Section will strive to process your offer and provide a decision within 90 days of receiving your completed application, documentation, and deposit of funds.

Offers are subject to approval by the Attorney General's Office or its designee. An offer will not be approved if there are assets or income available to pay off the debt. A stipulated judgment must be filed, and you must pay the filing fees. You may also be required to put up collateral.

## 10. Common Errors Discovered in Audits: Shipments to Customers on Indian Reservations

Many businesses mistakenly believe that sales of merchandise shipped to a customer on an Indian reservation is automatically exempt from California sales and use tax.

For purposes of the Sales and Use Tax Law, "reservation" includes reservations, rancherias, and any land held by the United States in trust for any Indian tribe or individual Indian. "Indian" means any person of Indian descent who is entitled to receive services as an Indian from the U.S. Department of Interior. Indian organizations are entitled to the same exemption as are Indians. "Indian organization" includes Indian tribes, tribal organizations and partnerships all of whose members are Indians. The term also includes corporations organized under tribal authority and wholly owned by Indians. Other corporations, including those wholly owned by Indians, are excluded from the term.

Shipments of tangible personal property to customers on Indian reservations are not taxable if

- Your sale is to an Indian, *and*
- The property is delivered to the purchaser *and ownership to the property transfers to the purchaser on the reservation.* This second requirement is often not met by California sellers who ship merchandise by mail or by common carrier, such as UPS or Federal Express.

Ownership generally transfers when the purchaser takes possession of the property from the retailer. However, when delivery is made



by mail or other common carrier, ownership generally transfers at the time the seller gives the property to the carrier. Accordingly, sales by a California retailer will be subject to sales tax when shipped by mail or common carrier even though the property was shipped to an Indian customer on an Indian reservation.

For more information regarding the application of tax to sales on Indian reservations, including an explanation of how tax applies to construction contracts performed on Indian reservations, please order a copy of Regulation 1616, *Federal Areas*, from our Information Center.

## 11. New or Revised Reference Material

If you would like to obtain a copy of any of the following reference material, please call the Information Center. Copies of some publications can also be obtained from our website, [www.boe.ca.gov](http://www.boe.ca.gov).

### Sales and Use Tax Publications

- 71 California City and County Sales and Use Tax Rates (April 2000)
- 79B California Individual Use Tax (March 2000)
- 108 When Is Labor Taxable? (February 2000)

### Sales and Use Tax Regulations

- 1132 Shipments Out of the State (February 20, 2000)
- 1591 Medicines and Medical Devices (March 10, 2000)
  - 1591.1 Specific Medical Devices, Appliances and Related Supplies (March 10, 2000)
  - 1591.2 Wheelchairs, Crutches, Canes and Walkers (March 10, 2000)
  - 1591.3 Vehicles for Physically Handicapped Persons (March 10, 2000)
  - 1591.4 Medical Oxygen Delivery Systems (March 10, 2000)
- 1620 Interstate and Foreign Commerce (February 23, 2000)

## Do You File Tax Returns Once a Year?

If so, the only *Tax Information Bulletin* you receive is the one mailed with your return. If you would like to be added to a mailing list to receive each quarterly issue, you may write to us and ask to be added to mailing list #15. Write: Addressing Systems, MIC:12; Board of Equalization; PO Box 942879; Sacramento, CA 94279-0012

## How To Contact Us

**Information Center.** Call at any time to use our automated services, including our faxback service. To speak to a representative, call between 8:00 a.m. and 5:00 p.m., Monday through Friday, excluding State holidays.

**1-800-400-7115**

*Telephone devices for the deaf*

1-800-735-2929 (TDD phone)

1-800-735-2922 (voice phone)

**Internet.** Go to [www.boe.ca.gov](http://www.boe.ca.gov) to obtain information on tax rates, publications, legislation, regulations, telephone numbers, education programs, public meetings, and so forth. See also [www.taxes.ca.gov](http://www.taxes.ca.gov), the California Tax Information Center, for other federal and state tax information.

**Seller's Permit Verification.** To verify permit numbers, you can call **1-888-225-5263** to use our automated voice response system. Or you can visit our website, [www.boe.ca.gov](http://www.boe.ca.gov).

**Taxpayers' Rights Advocate.** Call the Advocate's office if you need help with a problem you have been unable to resolve at other levels. Call toll-free, **1-888-324-2798**.

**Tax Evasion Hotline.** Call to report suspected tax evasion. Call toll-free, **1-888-334-3300**.

**Copies of Legislative Bills.** Write to the Legislative Bill Room, State Capitol, Room B-32, Sacramento, CA 95814. Or visit the following website: [www.leginfo.ca.gov](http://www.leginfo.ca.gov). The Bill Room does not provide copies of Board forms or publications.