



CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

450 N STREET, SACRAMENTO, CA  
PO BOX 942879, SACRAMENTO, CA 94279-0092  
1-916-324-2830 • FAX 1-916-322-4530  
[www.cdtfa.ca.gov](http://www.cdtfa.ca.gov)

EDMUND G. BROWN JR.  
Governor

MARYBEL BATJER  
Secretary, Government Operations Agency

NICOLAS MADUROS  
Director

October 3, 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 AM Chapter 4, *General Audit Procedures*, by adding new section 0426.00, *Audit of the Prepaid Mobile Telephony Services Surcharge*. 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](mailto:AM.RevisionSuggestions@boe.ca.gov). Your comments or suggestions must be received by the CDTFA no later than **December 4, 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

## **AUDIT OF THE PREPAID MOBILE TELEPHONY SERVICES SURCHARGE**

**0426.00**

### **GENERAL**

**0426.05**

Effective January 1, 2016, a Prepaid Mobile Telephony Services (prepaid MTS) Surcharge<sup>1</sup> was imposed on consumers of prepaid wireless services and products purchased in a retail transaction in California. Sellers of prepaid wireless services and products are required to charge and collect the surcharge at the time of the sale. This law is set to sunset on January 1, 2020 (Revenue and Taxation Code (RTC) section 42024).

Under the law, a seller is defined as a person who sells prepaid MTS to another person in a retail transaction. This includes:

- indirect sellers such as third-party retailers, and
- direct sellers, such as prepaid MTS telecommunication service suppliers.

Telecommunication service suppliers who sell prepaid MTS directly to consumers are defined as “direct sellers.” Persons other than direct sellers who sell prepaid MTS to consumers are typically referred to as “indirect sellers.” Different registration, filing, and reporting requirements apply to indirect sellers than those that apply to direct sellers. AM section 0426.25 specifies the indirect seller requirements; AM section 0426.35 specifies the direct seller requirements. There is additional information in the *Prepaid Mobile Telephony Services (MTS) Surcharge tax and fee guide*.

### **SMALL SELLER EXEMPTION**

Beginning January 1, 2017, indirect sellers with less than \$15,000 of prepaid MTS sales in the prior calendar year are not required to charge and collect the surcharge from their customers. For sellers who have more than one location, sales of prepaid MTS from all locations must be used to determine annual sales.

Indirect sellers must maintain adequate records to show their annual prepaid MTS sales are less than \$15,000. (Note: The \$15,000 threshold is subject to annual adjustments by the Department of Finance.) The small seller exemption does *not* apply to direct sellers.

Customers who purchase prepaid MTS from indirect sellers who do not charge and collect the surcharge are responsible for reporting and paying the surcharge directly to the California Department of Tax and Fee Administration (CDTFA). Purchasers may report and pay their prepaid MTS surcharge on a one-time purchase through the CDTFA’s online system. As a convenience to their customers indirect sellers, who qualify for the small seller exemption, may voluntarily collect the surcharge from their customers and report and pay the amounts to the CDTFA.

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<sup>1</sup> For purposes of this Audit Manual section when the term “prepaid MTS surcharge” is used, it refers to all three components of the surcharge: amounts for the emergency telephone users (prepaid 911) surcharge, the California Public Utilities Commission reimbursement fee and universal services surcharges, and any local charges imposed on prepaid MTS.

The law requires all sellers, including those meeting the small seller exemption, to be registered with the CDTFA to collect and remit the surcharge through December 31, 2016. On and after January 1, 2017, indirect sellers qualifying for the small seller exemption, and who do not voluntarily collect and remit the surcharge, are not required to be registered with the CDTFA. This includes indirect sellers who begin operating and selling prepaid MTS on or after January 1, 2017, and project prepaid MTS sales of less than \$15,000 in the next calendar year. Nevertheless, any person claiming the small seller exemption must maintain the requisite documentation to support that their prior year's sales did not meet or exceed the minimum threshold (currently \$15,000 to qualify as a small seller for the 2017 calendar year).

### **PREPAID MTS SURCHARGE RATE**

The CDTFA is required to annually calculate the prepaid MTS surcharge rate by adding:

- The prepaid 911, surcharge rate as determined by the Office of Emergency Services (OES),
- The California Public Utilities Commission (CPUC) reimbursement fee and the telecommunications universal service surcharges, and
- Local charges, if any, which apply for the jurisdiction in which the sale occurs.

The CDTFA will post the combined total of the prepaid MTS surcharge rate and local rate(s) for each jurisdiction by December 1 of each year, to be effective the following January 1. Any new local charges and increases to existing local charges will be posted to the CDTFA's website by March 1 and be effective on April 1. A detailed breakdown of the current individual rates for the prepaid 911 surcharge, CPUC surcharges and fee, and a separate listing of local charges is available on the *Prepaid Mobile Telephony Services (MTS) Surcharge Rates* page, under the *Resources* section.

### **ITEMS SUBJECT TO THE PREPAID MTS SURCHARGE**

**0426.10**

All prepaid wireless services and plans which customers purchase in predetermined units or dollars prior to using the service are subject to the prepaid MTS surcharge. The surcharge generally applies to sales of:

- Prepaid wireless airtime cards,
- Prepaid wireless cards compatible with pay-as-you-go cell phones,
- Prepaid wireless minutes,
- Prepaid wireless plans,
- Prepaid wireless refill or top-off cards,
- Prepaid SIM cards (with minutes/airtime),
- Prepaid wireless "e-Cards,"
- Prepaid mobile data or any other services when sold with any of the above,
- Any product or service (except a cell phone), when sold with prepaid MTS for a single non-itemized price, and
- A cell phone sold with prepaid MTS for a single non-itemized price, unless only a minimal amount of prepaid MTS is transferred. A minimal amount of prepaid MTS is \$5 or less, or 10 minutes or less.

## **RETAIL TRANSACTIONS AND APPLICABLE RATES**

**0426.15**

For purposes of collecting the prepaid MTS surcharge and local charge(s), a retail transaction occurs in this state if the prepaid consumer makes the retail transaction in person at a California business location (point-of-sale transaction). Furthermore, when the transaction does not occur in person at a California business location, the retail transaction is presumed to occur in California and the prepaid MTS surcharge applies when:

- The item is shipped/delivered to, or picked up by, a customer at a California location, or
- The seller's records show that the customer's address is located in California, or
- The customer provides an address in California during the sales transaction (for example, a billing address), or
- The mobile telephone number is associated with a location in California. This only applies if an address for the customer is not available.

Sellers making sales of prepaid MTS products/services from their business location should generally charge and collect the proper prepaid MTS surcharge rate for the city and/or county where the business is located. When the sale does not take place in person at the business location, but one of the above scenarios applies, the seller should charge the prepaid MTS surcharge rate that applies to the above known California location or address of the customer, in the order listed above.

## **LOCAL CHARGES**

**0426.20**

Under the Local Prepaid Mobile Telephony Services Collection Act (RTC sections 42100-42111), cities and/or counties (local jurisdictions) that have an ordinance that applies its local charges to prepaid MTS *must* contract with the CDTFA to collect and administer its local charges on the sales of prepaid MTS. These local charges include utility user taxes (UUT), local 911 charges, and any other local charges for access to communication services that apply to prepaid MTS. Beginning January 1, 2016, if the local jurisdiction does not contract with the CDTFA, local charges imposed upon prepaid MTS will not be collected by sellers and the local jurisdictions will not receive local charge revenue from the sales of prepaid MTS in their jurisdiction.

Local jurisdictions that wish to contract with the CDTFA or have questions about the collection and administration of local charges with the prepaid MTS surcharge should be directed to the Local Revenue Branch (LRB) at (916) 324-3000, or by email at [LRB-juri@CDTFA.ca.gov](mailto:LRB-juri@CDTFA.ca.gov).

For detailed information about the local charges see the *Local Jurisdictions* section of the *Prepaid Mobile Telephony Services Surcharge* tax and fee guide.

## **INDIRECT SELLERS (THIRD-PARTY RETAILERS) — SM ACCOUNTS**

**0426.25**

The Field Operations Division (FOD) and the Business Tax and Fee Division (BTFD) are responsible for the administration of indirect seller accounts. Indirect sellers of prepaid MTS have a Taxable Activity Type (TAT) of SM. The SM account requires

separate registration and filing from other TATs. All indirect sellers of prepaid MTS are required to register for an SM account, even if they currently hold a seller's permit.

### **RETURN FILING FOR SM ACCOUNTS**

Indirect sellers of prepaid MTS are required to electronically file their return quarterly with the CDTFA. The return for prepaid MTS is separate from returns filed for other CDTFA accounts. The prepaid MTS return will allow for the following deductions and exemptions:

- Sales to Other Retailers for the Purposes of Resale
- Out of State Transactions
- Surcharge (if any) included in Gross Sales of Prepaid MTS
- Bad Debt Losses on Sales of prepaid MTS
- Lifeline Exemption

### **REQUESTS FOR RELIEF**

Online relief requests are available for SM accounts. Surcharge payers can file for relief of penalty, interest, or the collection cost recovery fee on the CDTFA's website. A Declaration of Timely Mailings (Form CDTFA-135-A) is also available to be filed online to support that the original return or payment was mailed timely.

### **PETITIONS AND CLAIMS FOR REFUND**

In general, petitions and claims for refund for SM accounts follow the normal procedures currently in place for sales and use tax accounts.

Because the surcharge is imposed on the prepaid consumer, the seller (SM account holder) or the prepaid consumer may file a claim for refund directly with the CDTFA. The local jurisdiction is solely responsible for handling any claims regarding the validity of a local ordinance in its application to prepaid MTS, or interpreting any provision of their local ordinance (except to the extent superseded by these acts). The Audit Determination and Refund Section (ADRS) generally processes all claims received unless the claim pertains to local charges and is based on one of the issues in RTC section 42105 subdivisions (b), (c), or (d). When a claimant files a refund claim with the CDTFA pertaining to 1) the location of the retail transaction, 2) whether the consumer is exempt from the local charges under a local enactment, or 3) a claim citing the invalidity of a local tax ordinance, ADRS will direct the claimant to file the local charge portion of the claim with the appropriate local jurisdiction using form CDTFA-1492-CR, *Prepaid Mobile Telephony Services (MTS) Local Charge Refund Referral*.

### **AUDITS OF SM ACCOUNTS**

**0426.30**

If a sales and use tax account selected for audit has a related SM account, audit staff should conduct an audit of the SM account. Audit staff will prepare a separate audit report for each account. SM audit reports follow existing digital audit procedures.

### **VERIFICATION OF ACCOUNT STATUS**

Audit staff is responsible for verifying that sellers of prepaid MTS are properly registered and in compliance with the prepaid MTS program.

### **Agency Agreements**

If a prepaid MTS retailer does not have a SM account because they claim they are the agent of the telecommunication service supplier (i.e., direct seller) with respect to their prepaid MTS sales, audit staff should ask to see a copy of the Agency Agreement between the retailer (store owner or operator) and the direct seller.

The Agency Agreement must be signed by both parties and must establish an agency relationship for purposes of prepaid MTS. The agreement should specify that the carrier is the seller of the prepaid MTS and the store owner/operator is only acting as an agent of the carrier in selling prepaid MTS and collecting any applicable taxes/fees imposed on the prepaid MTS, including the prepaid MTS surcharge and local charges.

When the retailer and direct seller have a valid Agency Agreement, audit staff should then verify that the direct seller is correctly registered with a TU account. If audit staff finds an error with the direct seller's TU account registration, they should contact the BTFD Compliance Branch's Registration and Licensing Section.

## **AUDIT REPORTS**

### **Report of Field Audit**

SM accounts have a separate audit case ID number from the audit case ID number of a related SR account. Audit staff will prepare a separate audit report for SM accounts using the Audit Forms (Start 21) and the Audit Workbook.

### **No Opinion Warranted (NOW) Reports for SM Accounts**

An audit investigation of an SM account may result in a NOW audit recommendation. Audit staff should follow the same criteria as an SR account in determining if a NOW is appropriate. Audit staff should follow existing SR direction in preparing and completing the NOW, i.e., by using the Audit Summary Workbook or CDTFA-1010, *No Opinion Warranted Form*.

### **Transcript of Returns**

Audit staff may upload the prepaid MTS transcript of returns filed for SM accounts in the same manner as SR accounts.

## **AUDIT PROCEDURES**

Audit staff will conduct SM audits similar to sales and use tax audits, i.e., reconcile recorded to reported sales, verify claimed deductions, such as sales for resale, out-of-state sales, bad debts, etc., and include the following procedures:

### **Verification of Transactions Subject to the Prepaid MTS Surcharge**

Audit staff will verify that the retailer is correctly collecting the surcharge on sales of prepaid MTS services and products. See AM section 0426.10 and the online tax and fee guide, *Prepaid Mobile Telephony Services Surcharge*, for guidance on transactions subject to the surcharge.

### **Verification of Correct Prepaid MTS Rates Charged**

The prepaid MTS surcharge rate for each city and/or county is listed on the *Prepaid Mobile Telephony Services (MTS) Surcharge Rates* webpage. Audit staff will



verify that the retailer is charging the correct prepaid MTS surcharge rate for their retail transactions. For guidance on what rate retailers should charge, see the online tax and fee guide, *Prepaid Mobile Telephony Services Surcharge*, under the *MTS Rates* tab. The guide includes links to an archive of prior year rates.

Unreported or additional sales subject to the prepaid MTS surcharge should be assessed at the proper rate, including any applicable local charges. However, because the CDTFA is not responsible for refunding local charges based on the issues described in RTC section 42105 subdivisions (b), (c), or (d), auditors should not allow an adjustment in the audit for either a refund or an offset of the local portion of the surcharge that involves any of these issues. In such circumstances, the surcharge payer should be directed to file a claim for refund or credit with the local jurisdiction (see AM section 0426.25). The statewide prepaid MTS surcharge rate is subject to annual adjustment.

### **Reimbursement Costs**

Prepaid MTS sellers (other than direct sellers) may retain 2% of the prepaid MTS surcharge (including local charges) collected as reimbursement for part of their costs for collecting the prepaid MTS surcharge. The amount is claimed on the prepaid MTS return and reduces the overall surcharge liability. The reimbursement amount is automatically calculated and deducted on the SM return. Audit staff should verify that the retailer correctly reported their gross prepaid MTS sales prior to deducting the reimbursement costs.

### **Small Seller Exemption**

Beginning January 1, 2017, prepaid MTS sellers (other than direct sellers) with less than \$15,000 of prepaid MTS sales in the previous calendar year are no longer required to charge and collect the surcharge from their customers; see AM Section 0426.05. Sellers claiming the small seller exemption are required to maintain records of their prepaid MTS sales. Audit staff will verify that these sellers qualify for the small seller exemption.

### **Lifeline Exemption for Direct Sellers (RTC Section 42012)**

Purchases by a consumer of prepaid MTS, either alone or in combination with mobile data or other services, are exempt if all of the following apply:

- The prepaid consumer is certified eligible for the state lifeline program or federal lifeline program.
- The seller is authorized to provide lifeline service under the state lifeline program or federal lifeline program.
- The exemption is applied only to the amount paid for the portion of the prepaid mobile telephony service that the lifeline program specifies is exempt from the surcharges and fees that comprise the prepaid MTS surcharge.

Generally, only TU accounts can qualify for the lifeline exemption because the statute requires that for the exemption to apply, the person selling the prepaid services to the consumer must be an authorized lifeline telecommunications service provider (i.e., service supplier). If an SM account claims exempt lifeline sales, audit staff should ask for documentation establishing that the retailer claiming the exemption is authorized to supply prepaid lifeline telecommunications services, and should investigate whether the seller should be registered as a TU

account. A third party retailer cannot claim lifeline exempt sales on behalf of a direct seller.

### **AUDIT UPLOADS**

SM audit report uploads will follow the existing procedures for SR accounts. One additional noncompliance code for “Lifeline Exemption” specific to prepaid MTS was added.

### **PURCHASER REGISTRATION (79B ACCOUNTS)**

Beginning in June 2017, purchasers buying prepaid MTS for use in this state who did not pay the surcharge to a registered California retailer can report and pay the surcharge directly to the CDTFA. The online registration system allows purchasers to report and pay the surcharge on a one-time purchase of prepaid MTS.

### **TELECOMMUNICATION SERVICE SUPPLIERS (DIRECT SELLERS) — TU ACCOUNTS**

**0426.35**

The BTFD is responsible for the administration of direct sellers’ accounts. A “direct seller” is defined as a prepaid MTS provider or service supplier (per RTC section 41007) who makes a sale of prepaid MTS (or prepaid wireless service) directly to a consumer in a retail transaction occurring in this state. A direct seller includes a:

- Telephone corporation (as defined in Public Utilities Code section 234), or
- An interconnected Voice over Internet Protocol (VoIP) service provider as defined in Public Utilities Code section 285, or
- A retailer (as defined in RTC section 6203) that is a member of the same commonly controlled group (as defined in RTC section 25105), or who is a member of the same combined reporting group (as defined in paragraph (3) of subdivision (b) of section 25106.5 of Title 18 of the California Code of Regulations, as an entity described above.

A direct seller is required to:

- Register with the CDTFA under the Emergency Telephone Users (911) Surcharge (ETUS) law, if not currently registered,
- Know the correct prepaid MTS surcharge rate and any applicable local rates,
- Charge and collect the prepaid MTS surcharge from its customers on sales of prepaid MTS,
- Electronically file and pay CDTFA-501-TE, *Emergency Telephone Users Surcharge Return* to the CDTFA,
- Pay the portion of the prepaid MTS surcharge that consists of the CPUC reimbursement fee and surcharges directly to the CPUC, and
- Pay any applicable local charges directly to the local jurisdiction or local agency imposing the local charge.

Direct sellers are registered under ETUS as a TU account. If the surcharge payer is currently registered under ETUS, they do not need to register again as a direct seller.

### **RETURN FILING FOR DIRECT SELLERS**

Direct sellers must electronically file CDTFA-501-TE, *Emergency Telephone Users Surcharge Return*, include the portion of the prepaid MTS surcharge that consists of



the prepaid 911 surcharge, and pay the reported amounts to the CDTFA. Direct sellers may claim bad debts related to prepaid MTS amounts subject to the surcharge (i.e., worthless accounts written off for income tax purposes) on the CDTFA-501-TE. Sales subject to the prepaid MTS surcharge should be reported net of sales that qualify for the section 42012 lifeline exemption (see AM section 0426.30).

Direct sellers must also pay the portion of the prepaid MTS surcharge that consists of the CPUC surcharges directly to the CPUC and pay any applicable local charges directly to the local jurisdiction or local agency imposing the local charge.

### **Refusal to Pay Schedule**

TU accounts must submit CDTFA-507-TEA, *Refusal to Pay Schedule*, providing the names and addresses for any consumer who refuses to pay \$3.00 or more of the ETUS and/or prepaid 911 surcharge. The BTFD Return Processing Branch will issue consumers listed on the schedule a Notice of Determination.

### **Billing Aggregator Schedule**

TU accounts who report on behalf of another service provider can elect to electronically file a single return on behalf of multiple service providers. They must file a billing aggregator schedule (CDTFA-507-TE) identifying the total charges reported and total surcharge due on behalf of each service provider and their corresponding account number.

### **AUDIT PROCEDURES**

Audit staff will conduct TU audits using the current procedures for special tax and fee audits and adding a reconciliation for the amount of prepaid 911 surcharge due based on the total prepaid MTS sold.

- Agency Agreements – For Information see AM section 0426.30, under *Verification of Account Status*.

### **PETITIONS AND CLAIMS FOR REFUND**

Petitions and claims for refund follow the normal processes for TU accounts and are processed by the Appeals and Data Analysis Branch (ADAB). With the exception of petitions on Guaranteed Minimum Funding billings, explained in the following paragraph.

### **CALCULATION OF EMERGENCY TELEPHONE USERS SURCHARGE GUARANTEED MINIMUM FUNDING**

Under section 41033 of the ETUS Law, the total collection for the prepaid 911 surcharge must total \$9,900,000 per fiscal year, net of certain deductions and expenses. If the total collection results in less than \$9,900,000, each direct seller will be issued a deficiency determination for their pro rata portion of the difference. Each determination will be on a pro rata basis based upon each direct seller's percentage share of total California intrastate prepaid MTS revenues for the prior fiscal year.

Beginning with the 2016–17 fiscal year and ending with the 2018–19 fiscal year, the Program Administration Branch will calculate the following on or before November 1 following the end of the respective fiscal year:

- The total collections for the fiscal year of the portion of the prepaid MTS surcharge that is for the prepaid 911 surcharge, net of any amounts that an

indirect seller was permitted to deduct and retain pursuant to subdivision (e) of section 42010.

- Less costs incurred by the CDTFA for the fiscal year from that portion of the prepaid MTS surcharge that is for the prepaid 911 surcharge pursuant to subdivision (e) of section 42020.

The CDTFA will provide notification of whether the amount calculated exceeds or is less than \$9,900,000 on its public website by December 15 following the calculation, along with the underlying calculations, assumptions, and methodology. Guaranteed Minimum Funding Deficiency Determinations will be issued to direct sellers, if necessary. Interest begins to accrue 60 days after the issuance of the billing.

- *Petitions of Guaranteed Minimum Funding Deficiency Determinations*

Direct sellers who wish to contest a minimum funding deficiency determination have 60 days to file a petition for redetermination. If one direct seller timely appeals a minimum funding deficiency determination, all liabilities issued for the fiscal year will be automatically placed in petition status in IRIS. Appeals of the Guaranteed Minimum Funding Deficiency Determinations are acknowledged by the Appeals and Data Analysis Branch (ADAB). If the appeal involves contentions on the surcharge payer's market share, ADAB will forward the appeal to the California Public Utilities Commission for review. All direct sellers will receive a redetermination if one or more direct sellers successfully petition their billing.