



STATE BOARD OF EQUALIZATION

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June 14, 2005

Dear Interested Party:

Staff has reviewed comments received in response to our May 10, 2005, interested parties meeting regarding the proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*. After considering the comments and information provided to date, staff is recommending more amendments to Regulation 1802.

Enclosed is the *Second Discussion Paper* on this subject. This document provides a discussion of the issue and explains staff's recommendation in more detail. Also enclosed for your review is a copy of the proposed amendment to Regulation 1802 (Exhibit 1), and background information (Exhibit 2).

A second interested parties meeting is scheduled for **June 23, 2005 at 10:00 A.M. in Room 122** to discuss the proposed amendments to Regulation 1802. If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the June 23 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on June 23, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Ms. Cecilia Watkins at (916) 445-2137 or by e-mail at Cecilia.Watkins@boe.ca.gov prior to June 17, 2005. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing.

Any comments you may wish to submit subsequent to the June 23 meeting must be received by **July 11, 2005**. They should be submitted in writing to the above address. After considering all comments, staff will complete a formal issue paper on the proposed amendments to Regulation 1802 for discussion at the **Business Taxes Committee meeting** scheduled for **August 31, 2005**. Copies of the formal issue paper will be mailed to you approximately ten days prior to this meeting. Your attendance at the August Business Taxes Committee meeting is welcomed and encouraged. The meeting is scheduled for **9:30 a.m.** in Room 121 at 450 N Street, Sacramento, California.

Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

We look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Khabbaz, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,

Jeffrey L. McGuire
Tax Policy Manager
Sales and Use Tax Department

JLM: caw

Enclosures

cc: (all with enclosures)
Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member, First District
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Ms. Judi Apfel, Board Member's Office, First District (via e-mail)
Ms. Sabina Crocette, Board Member's Office, First District
Mr. Kenneth Topper, Board Member's Office, First District (MIC 71)
Mr. Steve Kamp, Board Member's Office, First District (via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Ms. Randie L. Henry (MIC 43)
Ms. Selvi Stanislaus (MIC 82)
Mr. Randy Ferris (MIC 82)
Mr. John Waid (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Mr. Todd Gilman (MIC 70)

Mr. Dave Hayes (MIC 67)
Mr. Joseph Young (via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Cecilia Watkins (MIC 50)
Mr. Peter Horton (MIC 50)

SECOND DISCUSSION PAPER

Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Tax – Warehouse Rule Issue

I. Issue

Should Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, be amended to extend direct distribution of local sales tax revenue to the city, county, or city and county where the retailer's stock of tangible personal property is located, in cases where the retailer has sales offices in this state but the sale is negotiated out of state and fulfilled by the retailer's employees from the retailer's in-state stock of goods?

II. Staff Recommendation

Staff proposes amending Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, as follows:

- Add new subdivision 1802(c), *Transactions Negotiated Out Of State and Delivered from the Retailers' Stock of Tangible Personal Property in California*, with two new subdivisions (c)(1) and (c)(2). The title for this subdivision has changed from the original title (*Out-of-State Retailers Who Maintain a Stock of Tangible Personal Property in California*) that was proposed in the Initial Discussion Paper in order to properly address what the proposed amendments intend to accomplish. The focus should be on the nature of the transaction, not the identity of the retailer. The "out-of-state retailer" language was inadvertently carried over from the existing language when drafting the new language. However, the proposed amendment applies to both California-based retailers with out-of-state sales offices, as well as to out-of-state based retailers with out-of-state sales offices.

New subdivision (c)(1) will replace current subdivision (b)(5) concerning the place of sale for out-of-state retailers that do not have a permanent place of business in California. The operative date of October 1, 1993 will be moved to the last sentence within the paragraph to clarify that it applies only to the local tax collected by the Board and distributed directly to the location of the warehouse.

New subdivision (c)(2) would add language concerning the place of sale by all retailers (California or out of state based) that have permanent sales offices in this state in addition to stocks of tangible personal property at other locations (warehouses). This language would clarify that the "place of sale" for purposes of distribution of the local tax is the city, county, or city and county in which the delivering or shipping warehouse is located, provided:

- The sale is negotiated out of state,
- There is no participation in the sale by the retailer's permanent place of business in this state, and
- The sale is filled by the retailer's employees from the retailer's in-state stock of goods.

This subdivision would also provide that, operative July 1, 2006, local tax collected by the Board for such sales will be distributed to the location of the warehouse.

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In addition, subdivision (c)(2) will require the issuance of seller's permits or development of other administrative mechanism to separately report out-of-state sales fulfilled by warehouses belonging to the retailer who have other sales offices in this state but the sale is negotiated out of state and fulfilled from the retailer's in-state stock of goods with the involvement of the retailer's employees.

- Current subdivision 1802(c), *Allocation of Sales Tax and Application of Use Tax*, will be renumbered as 1802(d), and current subdivisions 1802(b)(6) and (7) will be renumbered respectively as 1802(b)(5) and (6).

Staff's recommendation clarifies that the "place of sale" for purposes of distributing local tax on a shipment or delivery of goods from a retailer's in-state warehouse has always been, since the beginning of the local tax system, the location of the goods in this state, provided the sale is negotiated outside the state (warehouse rule), and the 1993 amendments were intended to address the issue of direct distribution, rather than the place of sale.

If the Board adopts staff's proposal, a conforming amendment to Regulation 1699(a) will also be necessary.

Staff's proposed amendments to Regulation 1802 are attached as Exhibit 1.

The Business Taxes Committee (BTC) is scheduled to discuss this issue at its meeting on August 31, 2005.

III. Other Alternative(s) Considered

Six interested parties timely submitted proposed alternatives, including the City of Ontario (Ontario), the City of Stockton (Stockton), the City of Long Beach (Long Beach), Mr. Glenn Bystrom, CPA (Mr. Bystrom), Mr. Robert E. Cendejas (Mr. Cendejas), and Mr. Albin Koch, General Tax Counsel for Muniservice Company, MBIA (MBIA). Interested parties appear to be in general agreement with the staff's proposed revisions. However, they expressed concerns in regard to the following:

1. The proposed language regarding participation in the sale by the in-state office needs clarification.
2. The timing of the proposed regulatory amendments and the proposed operative date could impact pending local tax appeal cases.

These alternatives are discussed in detail in Section V, Discussion.

SECOND DISCUSSION PAPER

Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Tax – Warehouse Rule Issue

IV. Background

Local Tax History

The warehouse rule, which determines whether or not certain transactions are subject to sales tax, rather than use tax, dates to the beginning of the sales tax in 1933. The current allocation rules were developed by Board staff working in concert with cities, counties, and retailers when the local tax system was instituted in 1956. These rules were validated by the decision in the case *City of Commerce v. St. Bd. of Equal.* (1962) 205 Cal. App. 2d 387, 392. The system balanced the needs and desires of the participating jurisdictions against the administrative burdens and expenses of the retailers preparing the local tax returns and schedules, and reporting and paying sales and use taxes. For additional background information, see Exhibit 2.

Current Application of Tax

For sales tax transactions affected by the warehouse rule, the place of sale is the location of the stock of goods, usually a warehouse. The issue is whether or not the local sales tax revenue derived from the sale should be distributed to the warehouse location directly or indirectly through a countywide pool. Currently, Regulation 1802(b)(5) provides for direct allocation of local sales tax revenue to the locations of stocks of goods only when the retailer does not have sales offices located in this state. If the retailer has sales offices in state, the local sales tax revenue goes to the location of the stock of goods through the medium of the countywide pool.¹

V. Discussion

Subsequent to the interested parties meeting held on May 10, 2005, staff received six written comments from interested parties. As noted above, there is a general agreement with the need to amend Regulation 1802 as proposed by staff, except for the following concerns grouped into two categories and discussed below:

¹ The countywide pools are a system designed to indirectly distribute the local portion of the sales or use tax reported, for specified transactions. When sales transactions are negotiated out of state rather than at the retailer's in-state place of business, and the order is fulfilled from the retailer's in-state stock of merchandise, the sales tax is not identified with a specific registered place of business and the tax generally is allocated to the local jurisdictions in the county where the warehouse is located through a countywide pool. These taxpayers are issued an additional schedule (*Schedule B -Detailed Allocation by County of 1 Percent Uniform Local Sales and Use Tax*) with their sales and use tax returns to report their local tax. *Schedule B* lists each county within the state of California. At the end of each reporting quarter, the countywide pool totals are prorated among the cities, redevelopment areas, and the unincorporated area of each county using the proportion that the directly-reported tax for each city and unincorporated area of a county bears to the total directly-reported tax for the county as a whole. The pools account for about 10% of the local sales and use tax reported, with use tax accounting for the majority of the pooled revenues.

SECOND DISCUSSION PAPER

Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Tax – Warehouse Rule Issue

1. The proposed language regarding participation in the sale by the instate office needs clarification.

Mr. Bystrom proposed that staff clarify whether its proposed amendments affect the provisions of Regulation 1802(a)(1) regarding the place of sale when the retailer has an instate place of business that participates in the sale and the property is shipped from the instate warehouse. Subdivision (a)(1) provides in part that if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business.

Staff's proposed amendments do not affect the provisions of subdivision (a). To correct any ambiguity in staff's earlier language, staff added a sentence to proposed subdivision (c)(2) to clarify that the provisions apply when there is no participation of the retailer's permanent place of business in this state.

2. The timing of the proposed regulatory amendments and the proposed operative date could impact pending local tax appeal cases.

In support of these concerns, interested parties expressed the following:

- MBIA and other interested parties requested that the proposed amendments to Regulation 1802 be postponed until all related appeal cases have been considered on their facts and under current law.
- Ontario supports staff's efforts in amending Regulation 1802 with the understanding that the proposed amendments are currently applicable to pending appeals cases. The City believes that Regulations 1699 and 1802 support direct allocation and distribution of local tax by situs to the single jurisdiction where the warehouse is located even if the retailer has other permitized sales offices in this state without changing the current regulation. In addition, Mr. Cendejas, MBIA, Stockton and Long Beach believe that the proposed amendments should be considered declaratory of existing law and not prospective, i.e., they believe the proposed amendments should currently apply to the pending appeals cases.
- The interested parties believe that the operative date is not necessary. They believe the proposed language would only "clarify" current law, as understood by cities and counties with pending local tax appeals. Stockton and Long Beach expressed concerns that the prospective effective date is intended to cause the pending appeals to be rejected.
- The prospective operative date of July 1, 2006 should not be used against the outstanding appeals.

Staff disagrees with postponing the BTC issue. Staff believes that the BTC process will provide Board Members with information that will enable them to make better-informed decisions on the pending appeal cases.

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Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Tax – Warehouse Rule Issue

Several local tax reallocation inquiries in the appeals process involve the warehouse rule and were postponed pending the outcome of this issue. In general, the contentions made by the inquiring jurisdictions and their consultants (IJC's) in these cases is that the local tax should be allocated directly to the warehouse location even if the retailer has sales offices located in this state in addition to the warehouse. The IJC's, generally, believe that the retailer's warehouse should be issued a seller's permit under the authority of Regulation 1802(a)(2), and that "place of business" as used in Regulation 1699 includes a warehouse because it refers to any business location of the retailer that conducts business activities that are somehow related to sales.

Further, staff believes that the explicit language of Regulation 1802(b)(5) as it currently reads means what it says -- direct allocation of local sales tax revenue to the locations of stocks of goods may be made only when the retailer does not have sales offices located in this state. If the retailer has sales offices in state, the local sales tax revenue goes to the location of the stock of goods through the medium of the countywide pool. Accordingly, staff does not believe that the proposed changes apply to pending appeals cases unless the Board specifically makes the amendment retroactive.

Staff's recommendation to amend Regulation 1802 on a prospective basis is not intended to cause the pending appeals to be rejected. There are four appeal cases planned for Board hearing which have been placed in abeyance by Board Proceedings Division based on request by the Board's Legal Department and/or by the BTC Chair pending the outcome of this issue. It should be noted that two of these cases were already pending due to Supplemental Decision and Recommendations that are being prepared the Local Tax Appeals Auditor.

A comparison of the proposed new language with the current language of subdivision (b)(5) shows that the proposed language imposes a new requirement on affected retailers for direct reporting of local sales tax that was not in the regulation nor any other Board publication. In addition, it is standard Board policy to put on hold the cases that may be affected by BTC issues. Staff's recommendation that this regulation be implemented on a prospective basis² is primarily to mitigate the impact on the affected jurisdictions as well as the affected taxpayers. Finally, it has been standard Board policy, when changing accounting methods that affect retailers' tax reporting, to promulgate such changes prospectively. (See, e.g., Reg. 1521(c)(12), regarding on-site electric signs.)

² The potential impact of a retroactive date (i.e., no operative date) to this amendment to allocate local tax revenues directly to the jurisdiction where the warehouse is located rather than through the countywide pool would not increase the aggregate amount of tax reported by retailers; however, the tax gained by a city or county will be at the expense of the other jurisdictions participating in the county's pool where the warehouse is located. Also, it could result in an increase number of newly filed local tax reallocation inquiries. Further, for previously filed and denied local tax reallocation cases and cases currently in the appeals process, a retroactive date could result in reallocations that would extend back more than 10 years (these moneys are moneys that the cities and or counties have already spent). It could also result in a greater reporting burden on retailers who would have to go back in their records to report to individual cities instead of countywide pools.

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Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Tax – Warehouse Rule Issue

Prospective changes allow the Board to identify and notify all retailers affected by amendments to regulations and allow retailers the time to update computer programs and record keeping in order to comply with these amendments. In the case of local taxes, prospective application also gives local entities time to identify affected retailers within their jurisdictions to the Board to ensure that permits are issued in time for them to report properly on the operative date and to avoid mis-allocation problems.

Pursuant to Regulation 1807, the cities have a right to a Board hearing and staff is not advocating that this right be removed. The final decisions on these cases resides with the Board Members which make their final decision at the Board hearings. Whether it is determined that the proposed amendment to Regulation 1802, resolves the outstanding appeals or not, and whether the fact that the currently proposed prospective date may be included in an oral or written argument against the outstanding appeals before the Board should not affect a jurisdiction's ability to a fair hearing of their appeal before the Board Members.

The Board Members, at their own discretion, can make their decision on the pending appeals subsequent to the adoption of the proposed regulation as they have previously done in other cases for various other Board of Equalization programs that were also placed on abeyance pending BTC topics.

VI. Summary

Amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, will extend direct distribution of local sales tax revenue to the city, county, or city and county where the retailer's stock of tangible personal property is located (the warehouse), when the retailer has sales offices in this state but the sale is negotiated out of state and fulfilled by the retailer's employees from the retailer's in-state stock of goods.

Staff welcomes any comments, suggestions, and input from interested parties regarding proposed amendments to Regulation 1802.

Prepared by the Tax Policy Division, Sales and Use Tax Department.

Current as of 06/10/2005

Regulation 1802. PLACE OF SALE AND USE FOR PURPOSES OF BRADLEY BURNS UNIFORM LOCAL SALES AND USE TAXES.

References: Sections 6012.6, 6015, 6359, 6359.45, 7202, 7204.03 and 7205, Revenue and Taxation Code.

(a) IN GENERAL.

(1) **RETAILERS HAVING ONE PLACE OF BUSINESS.** For the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law, if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business unless the tangible personal property sold is delivered by the retailer or his or her agent to an out-of-state destination, or to a common carrier for delivery to an out-of-state destination.

(2) **RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS.**

(A) If a retailer has more than one place of business in this state but only one place of business participates in the sale, the sale occurs at that place of business.

(B) If a retailer has more than one place of business in this state which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee's activities will be attributed to the place of business out of which he or she works.

(3) **PLACE OF PASSAGE OF TITLE IMMATERIAL.** If title to the tangible personal property sold passes to the purchaser in California, it is immaterial that title passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.

(b) PLACE OF SALE IN SPECIFIC INSTANCES.

(1) **VENDING MACHINE OPERATORS.** The place of sale is the place at which the vending machine is located. If an operator purchases property under a resale certificate or from an out-of-state seller without payment of tax and the operator is the consumer of the property, for purposes of the use tax, the use occurs at the place where the vending machine is located.

(2) **ITINERANT MERCHANTS.** The place of sale with respect to sales made by sellers who have no permanent place of business and who sell from door to door for their own account shall be deemed to be in the county in which is located the seller's permanent address as shown on the seller's permit issued to him or her. If this address is in a county imposing sales and use taxes, sales tax applies with respect to all sales unless otherwise exempt. If this address is not in a county imposing sales and use taxes, he or she must collect the use tax with respect to property sold and delivered or shipped to customers located in a county imposing sales and use taxes.

(3) **RETAILERS UNDER SECTION 6015.** Persons regarded by the Board as retailers under Section 6015(b) of the Revenue and Taxation Code are regarded as selling tangible personal property through salespersons, representatives, peddlers, canvassers or agents who operate under or obtain the property from them. The place of sale shall be deemed to be:

(A) the business location of the retailer if the retailer has only one place of business in this state, exclusive of any door-to-door solicitations of orders, or

(B) the business location of the retailer where the principal negotiations are carried on, exclusive of any door-to-door solicitations of orders, if more than one in-state place of business of the retailer participates in the sale.

The amendments to paragraph (b)(3) apply only to transactions entered into on or after July 1, 1990.

(4) **AUCTIONEERS.** The place of sale by an auctioneer is the place at which the auction is held. Operative July 1, 1996, auctioneers shall report local sales tax revenue to the participating jurisdiction (as defined in subdivision (c) below) in which the sales take place, with respect to auction events which result in taxable sales in an aggregate amount of \$500,000 or more.

~~(5) OUT OF STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA. Operative October 1, 1993, if an out of state retailer does not have a permanent place of business in this state other than a stock of tangible personal property, the place of sale is the city, county, or city and county from which delivery or shipment is made. Local tax collected by the Board for such sales will be distributed to that city, county, or city and county.~~

~~(5)(6)~~ **FACTORY-BUILT SCHOOL BUILDINGS.** The place of sale or purchase of a factory-built school building (relocatable classroom) as defined in paragraph (c)(4)(B) of Regulation 1521 (18 CCR 1521), Construction Contractors, is the place of business of the retailer of the factory-built school building regardless of whether sale of the building includes installation or whether the building is placed upon a permanent foundation.

~~(6)(7)~~ **JET FUEL.**

(A) In General. The place of sale or purchase of jet fuel is the city, county, or city and county which is the point of the delivery of the jet fuel to the aircraft, if both of the following conditions are met:

1. The principal negotiations for the sale are conducted at the retailer's place of business in this state; and

2. The retailer has more than one place of business in the state.

(B) The local sales or use tax revenue derived from the sale or purchase of jet fuel under the conditions set forth in this subdivision shall be transmitted by the Board, to the city, county, or city and county where the airport is located at which such delivery occurs.

(C) Multi-Jurisdictional Airports. For the purposes of this regulation, the term "multi-jurisdictional airport" means and includes an airport that is owned or operated by a city, county, or city and county, that has enacted a state-administered local sales and use tax ordinance and as to which the owning or operating city, county, or city and county is different from the city, county, or city and county in which the airport is located. Through June 30, 2004, the local tax rate is imposed at 1.25% by Revenue and Taxation Code section 7202 (a). Operative July 1, 2004, the local tax rate is imposed at 1% by Revenue and Taxation Code section 7203.1. The local tax revenue derived from sales of jet fuel at a "multi-jurisdictional airport" shall, notwithstanding subdivision (B), be transmitted by the Board as follows:

1. In the case of the 0.25% local sales tax imposed by counties under Government Code section 29530 and Revenue and Taxation Code section 7202 (a), or operative July 1, 2004, imposed by counties under Revenue and Taxation Code section 7203.1(a)(1), half of the revenue to the county which owns or operates the airport (or in which the city which owns or operates the airport is located) and half to the county in which the airport is located.

2. In the case of the remaining 1% of the local sales tax imposed by counties under Revenue and Taxation Code section 7202(a), or operative July 1, 2004, the remaining 0.75%, imposed by counties under Revenue and Taxation Code section 7203.1(a)(2), and in the case of the local sales tax imposed by cities at a rate of up to 1%, or operative July 1, 2004, at a rate of up to 0.75% under Revenue and Taxation Code section 7203.1(a)(2), and offset against the local sales tax of the county in which the city is located under Revenue and Taxation Code section 7202(h), half of the revenue to the city which owns or operates the airport and half to the city in which the airport is located. If the airport is either owned or operated by a county or is located in the unincorporated area of a county, or is owned or operated by a county and is located in the unincorporated area of a different county, the local sales tax revenue which would have been transmitted to a city under this subdivision shall be transmitted to the corresponding county.

3. Notwithstanding the rules specified in subdivisions 1. and 2., the following special rules apply:

a. In the case of retail sales of jet fuel in which the point of the delivery of the jet fuel to the aircraft, as described in subdivision (A), is San Francisco International Airport, the Board shall transmit one-half of the local sales tax revenues derived from such sales to the City and County of San Francisco, and the other half to the County of San Mateo.

b. In the case of retail sales of jet fuel in which the point of the delivery of the jet fuel to the aircraft, as described in subdivision (A), is Ontario International Airport, the Board shall transmit local sales taxes with respect to those sales in accordance with both of the following:

c. All of the revenues that are derived from a local sales tax imposed by the City of Ontario shall be transmitted to that city.

d. All of the revenues that are derived from a local sales tax imposed by the County of San Bernardino shall be allocated to that county.

(D) Otherwise, as provided elsewhere in this regulation.

(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA

(1) If an out-of-state retailer does not have a permanent place of business in this state other than a stock of tangible personal property, the place of sale is the city, county, or city and county from which delivery or shipment is made. Operative October 1, 1993, local tax collected by the Board for such sales will be distributed to that city, county, or city and county.

(2) If a retailer has a permanent place of business in this state in addition to its stocks of tangible personal property, the place of sale, in cases where the sale is negotiated out of state and there is no participation by the retailer's permanent place of business in this state, is the city, county, or city and county from which delivery or shipment is made. Operative July 1, 2006, local tax collected by the Board for such sales will be distributed to the city, county, or city and county from which delivery or shipment is made.

(d)(e) ALLOCATION OF SALES TAX AND APPLICATION OF USE TAX.

Local sales tax is allocated to the place where the sale is deemed to take place under the above rules. The local use tax ordinance of the jurisdiction where the property at issue is put to its first functional use applies to such use. As used in this subdivision, the term "participating jurisdiction" means any city, city and county, or county which has entered into a contract with the Board for administration of that entity's local sales and use tax.

APPLICATION OF USE TAX GENERALLY.

(1) When the order for the property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state from a point outside this state, the transaction is subject to the local use tax ordinance of the participating jurisdiction where the first functional use is made. Operative July 1, 1996, for transactions of \$500,000 or more, except with respect to persons who register with the Board to collect use tax under Regulation 1684(c) (18 CCR 1684), the seller shall report the local use tax revenues derived therefrom directly to such participating jurisdiction.

(2) Operative July 1, 1996, if a person who is required to report and pay use tax directly to the Board makes a purchase in the amount of \$500,000 or more, that person shall report the local use tax revenues derived therefrom to the participating jurisdiction in which the first functional use of the property is made.

The amendments to paragraph (b)(4) and new paragraph (d)(e) shall apply prospectively only to transactions entered into on or after July 1, 1996. ~~New~~ Paragraph (d)(e) shall not apply to lease transactions.

Background

Local Tax History

The warehouse rule, for determining whether or not transactions subject to it are subject to sales tax rather than use tax, dates to the beginning of the sales tax itself in 1933. The existing allocation rules were developed when the local tax system was instituted in 1956 with Board staff working in concert with cities, counties, and retailers. (*City of Commerce v. St. Bd. Of Equal.* (1962) 205 Cal. App. 2d 387, 392.) The system balanced the needs and desires of the participating jurisdictions against the administrative burdens and expenses of the retailers, who would be preparing the local tax returns and schedules, and reporting and paying sales taxes or collecting use taxes.

When the local tax system began, the Board adopted Tax Ruling 2202, the predecessor to Regulation 1802, to interpret and implement Revenue and Taxation Code (RTC) section 7205 which sets forth the rules for determining the place of sale for local sales tax purposes. Tax Ruling 2202 addressed only negotiations at in-state sales offices. The Board later concluded that when the retailer had no sales offices in the state but shipped its goods from a stock of merchandise stored in the state, the location of the warehouse stock was regarded as the place of sale for all items shipped from that location even if the retailer did not own the warehouse. (Annot. 710.0020 (11/12/59).) The basis for the conclusion was that California could, under the federal constitution, require the out-of-state retailer to pay sales tax on such transactions, because the retailer had property in this State and the retailer's employees were involved in shipping or delivering that property to the customer. This is in contrast to the transactions that are the subject of Regulation 1802(a) and (b)(1) through (b)(4), which are based on the retailer conducting negotiations in this state with its customers.

In order for local sales tax to be able to be allocated directly to a jurisdiction, the business location must qualify for, and be issued, a seller's permit.¹ RTC Section 6066(a) requires that every person selling tangible personal property in this state obtain a seller's permit for each location at which the person intends to engage in the business of selling. Regulation 1699 (not Regulation 1802), sets forth the qualifications for issuing seller's permits to business locations. The predecessor to Regulation 1699, from 1939 to 1993, limited issuance of seller's permits to locations where retailers customarily negotiated sales with customers. Seller's permits were not issued to locations where merchandise was merely stored. The local sales tax revenue derived from sales falling under the warehouse rule was originally allocated to the location of the warehouse through the medium of the countywide pool system, because no provision was made to issue seller's permits to warehouse locations. The Board made this decision in order to reduce the administrative burdens on out-of-state retailers. This policy, developed in cooperation with interested parties, was carried forward when the rule regarding sales fulfilled from in-state stocks of goods was incorporated into Regulation 1802 as subdivision (b)(5) in 1970. At that time, subdivision (b)(5) explained: "If an out-of-state retailer does not have a permanent place of business in this state other than a stock of tangible personal property, the place of sale is the city, county, or city and county from which

¹ Strictly speaking, every retailer selling tangible personal property has a seller's permit. If a retailer has more than one selling location, each location is issued a sub-permit. For a retailer who had no in-state selling location, no subpermits were issued to in state stock of goods until 1993. Local sales tax was allocated to the jurisdiction of the warehouse using the countywide pools. For ease of reference, in this discussion we refer generally to the permit issued to a selling location as a "seller's permit."

delivery or shipment is made.” The local sales tax was distributed to the jurisdiction of the place of sale via the countywide pool.

Beginning in 1991, however, the Board Members, staff, and various cities held discussions regarding various methods of changing this system. At the March 4, 1992 Business Taxes Committee Meeting, the Board Members directed the staff to draft amendments to subdivision (b)(5) of Regulation 1802. This rule was changed, operative October 1, 1993, to provide that local sales tax revenue derived from such sales would be distributed directly to the city, county, or city and county in which the warehouse was located if the retailer had no sales offices in this state.² Under this rule, a seller’s permit is issued to a warehouse location pursuant to RTC section 6066 when the retailer has no sales offices located in this state. There was no discussion at the public hearing on the amendments about expanding the rule to provide for direct distribution when the retailer also had sales offices in the state.

² At the Public Hearings on the amendments, Board Members expressed concerns regarding increased reporting burdens on out-of-state retailers that the new amendments would create.