



STATE BOARD OF EQUALIZATION

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April 22, 2005

Dear Interested Party:

Enclosed is the *Discussion Paper* on proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*. The proposed amendments would 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. Discussion regarding the proposed amendments is scheduled for the Board's **August 31, 2005**, Business Taxes Committee meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. A meeting is scheduled in **Room 122 at 10 a.m. on May 10, 2005** at the Board of Equalization; 450 N Street; Sacramento, California.

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 May 10, 2005 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 May 10, 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 May 3, 2005. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122. In addition, please let Ms. Watkins know if you wish to have future correspondence sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **May 24, 2005**. 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.

Thank you for your consideration. I 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  
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. Sabina Crocette, Board Member's Office, First District  
Ms. Judy Apfel, Board Member's Office, First Dist (via e-mail)  
Mr. Ken Topper, Board Member's Office, First Dist (via e-mail)  
Mr. Steve Kamp, Board Member's Office, First Dist (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)  
Mr. Ramon J. Hirsig (MIC 73)  
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Ms. Carole Ruwart (MIC 82)  
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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. Vic Anderson (MIC 44 and via e-mail)  
Mr. Larry Bergkamp (via e-mail)  
Mr. Joseph Young (via e-mail)  
Mr. Dario Romano (MIC 35)  
Mr. Larry Micheli (MIC 27)  
Mr. Geoffrey E. Lyle (MIC 50)  
Ms. Leila Khabbaz (MIC 50)  
Ms. Cecilia Watkins (MIC 50)  
Mr. Peter Horton (MIC 50)

## INITIAL DISCUSSION PAPER

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

#### **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?

#### **Staff's Proposal**

Staff proposes that the Board amend Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, as illustrated in Exhibit 1 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 (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 proposes to address some of the recurring concerns expressed by interested parties and Board members at interested parties' meetings regarding the need to explore the issuance of seller's permits to warehouses in this state in cases where the retailer has 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. Such transactions are subject to sales tax because the retailer's property is located in this state, and the retailer's employees are involved in shipping or delivering the property to the customers. This rule is commonly called the "warehouse rule," even though, strictly speaking, it applies when any stock or goods belonging to the out-of-state retailer is involved and does not require that the retailer own the warehouse. For convenience, during this discussion staff shall refer to this rule as the "warehouse rule."

Staff's proposal broadens the Board's 1993 amendments of Regulation 1802(b)(5), which provided for *direct allocation of local sales tax revenue* to the locations of stocks of goods in transactions subject to the warehouse rule, only when the retailers do not have sales offices located in this state. Staff's proposal provides for *direct allocation of the local sales tax revenue* derived from such transactions to situations where the retailers do have sales offices located in this state, in contrast to allocation through the medium of the county-wide pool system, as it is currently done.

## INITIAL DISCUSSION PAPER

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

In 2004, staff held discussions with interested parties concerning the “place of sale” for local sales tax purposes when sales orders are placed, received and processed electronically. During that process, interested parties discussed possible amendments to Regulation 1802(b)(5) to allocate local taxes directly to the locations of stocks of goods in cases subject to the warehouse rule where the retailer has sales offices located in this state in addition to its stocks of goods, rather than to the location of the warehouse through the medium of the county-wide pool,<sup>1</sup> as it is currently done. In addition, several jurisdictions have filed local tax allocation appeals, attempting to obtain direct allocation in this situation through regulatory interpretation rather than through amendment. These appeals have had the beneficial side effect of making available information on specific retailers and jurisdictions that would be affected by such an allocation change and the amounts of revenue that would be moved.

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

#### 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

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<sup>1</sup> 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.

## INITIAL DISCUSSION PAPER

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

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)(1-4), which are based on the retailer conducting negotiations in this state with its customers.

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. In order for local sales tax to be able to be allocated directly to a jurisdiction, the retailer must be able to identify its business location to the sales tax system. In order to do that, the business location must qualify for, and be issued, a seller's permit.<sup>2</sup> Regulation 1699, rather than Regulation 1802, sets forth the qualifications for issuing seller's permits to business locations. The predecessor to Regulation 1699, Tax Ruling 79, adopted in 1939, limited issuance of seller's permits to locations where retailers customarily negotiated sales with customers. Under Regulation 1699(a), as had been the rule under tax ruling 79, seller's permits are not issued to locations where merchandise is merely stored. Since no permit could be issued to a warehouse location, no local sales tax revenues could be distributed directly to the location of a stock of goods. The only allocation method left was indirect allocation. 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 delivery or shipment is made." The local sales tax revenue derived from such sales 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.

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.<sup>3</sup> 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.

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<sup>2</sup> 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 ease of reference, in this discussion we refer generally to the permit issued to a selling location as a "seller's permit."

<sup>3</sup> At the Public Hearings on the amendments, several Board Members expressed concerns regarding increased reporting burdens on out-of-state retailers that the new amendments would create.

## INITIAL DISCUSSION PAPER

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

#### Current Application of Tax

In sales where the applicable tax is sales tax due to the operation of the warehouse rule, the place of sale is the location of the stock of goods, usually a warehouse. The problem is whether or not the local sales tax revenue derived from the sale can be distributed to the warehouse location directly or indirectly. 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.

#### **Discussion**

As commerce has evolved in this country, many out-of-state retailers have established permanent warehouses in many cities in this state. These warehouses are either owned or leased on a long-term basis by the retailer. Staff, as well as other interested parties, are of the opinion that a direct allocation of local taxes in such cases, makes better sense. This amendment will provide for distribution of local tax revenue directly to the jurisdictions, which bear the primary, if not the entire, financial burden (for providing municipal services, such as police and fire protection, infrastructure, maintenance, and street cleaning) to the warehouse operation.<sup>4</sup>

Staff believes that the time is right to re-examine the current policy. Recent newspaper articles indicate that the distribution industry may be in the process of consolidating facilities. An example can be found in Board records. One retailer with no sales offices in this state but which fulfills its sales from in-state stocks of goods had approximately thirty permitized locations in 1995. By 2001, it was down to two. It may thus be that the burden of reporting to multiple locations that so concerned the Board in 1993 has been considerably alleviated due to changes in the industry.

There has also been a significant development in case law. In the recent case of *Carson v. La Mirada* (2004) 125 Cal. App. 4th 532, 541-542, a court of appeal ruled that a distribution center was a “store” for the purposes of the “big box retailer” law. (See Cal. Health & Saf. Code § 33426.7; Cal. Govt. Code § 53084.) The retailer had no sales offices located in state and apparently utilized the service of independent sales agents.<sup>5</sup> While customers did not negotiate sales at the distribution centers, they could visit a showroom at each center to view the retailer’s

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<sup>4</sup> Following is an example the local sales tax revenue being distributed to the location of the warehouse through the medium of the countywide pool: At the end of each reporting quarter, the countywide pool totals are prorated among all the jurisdictions using the proportion (%) of 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. For example, if county pool “A” received \$1,000 dollars, and for the sake of convenience County A has three cities which received a total directly-reported tax of \$500 as follows: city 1: \$200 (40%); city 2: \$250(50%) and city 3: \$50 (10%); the pool prorated amounts would be distributed as follows: city 1: \$400 (40% X \$1,000); city 2: \$500 (50% X \$1,000); and city 3: \$100 (10% X \$1,000). So if the warehouse was located in city 3, this city only gets 10% of the total pool amount.

<sup>5</sup> The relationship of the retailer to the sales agents is not made clear in the opinion.

## INITIAL DISCUSSION PAPER

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

products. The court, applying the dictionary definition of “store,” and citing RTC Section 6007, concluded that the distribution facility of the retailer at issue in that matter was a “store,” as Carson contended, and not a “warehouse,” as La Mirada contended. As a result of the holding of this case, it seems to be appropriate for the Board to review its policy as regards to retailers’ stocks of goods at this time.

In determining whether or not to distribute local sales tax revenue directly to the city, county, or city and county, we must determine the following: (a) Is the transaction subject to sales tax or use tax? (b) If a transaction is subject to sales tax, what is the location in this state in which the retailer is engaged in business of selling tangible personal property, and can this location be issued a seller’s permit? (c) Which of the retailer’s permitized places of business is the “place of sale” for the purpose of allocating the local tax revenues derived from the transaction in question?

#### (a) Is the transaction subject to sales tax or use tax?

Regulation 1620 states the rules for determining whether the appropriate tax is a sales or use tax. In general, sales tax applies when there is transfer of title in this state along with local participation. Sales tax in warehouse rule circumstances applies because the retailer’s in-state employees fulfill orders placed out of state from the retailer’s in-state stock of goods.

This amendment deals specifically with *sales tax*. No change is being proposed to the allocation of use tax.<sup>6</sup>

#### (b) If a transaction is subject to sales tax, what is the location in this state in which the retailer is engaged in business of selling tangible personal property, and can this location be issued a seller’s permit?

RTC section 6066, interpreted and implemented by Regulation 1699, specifies the kind of business location for which a seller's permit may be issued. Regulation 1699 provides, in pertinent part:

(a) Every person engaged in the business of selling ... tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers. For example:

A permit is required for a branch sales office at which orders are customarily taken and contracts negotiated, whether or not merchandise is stocked there.

No additional permits are required for warehouses or other places at which merchandise is merely stored and which customers do not customarily visit for the purpose of making purchases and which are maintained in conjunction with a place of business for which a permit is held; but at least one permit must be held by every person maintaining stocks of merchandise in this state for sale.

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<sup>6</sup> In addition, staff’s proposal is limited to transactions where the sales negotiations are conducted out of state.

## INITIAL DISCUSSION PAPER

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

Therefore, if a business location does not qualify for a seller's permit under RTC section 6066, it cannot obtain a permit under Regulation 1699. If the retailer has a sales office in California that is registered with the Board under Regulation 1699(a), a permit cannot properly be issued to the retailer's warehouse location. As a result, a permit can be issued to a warehouse location, thus permitting direct distribution of local sales tax revenues when the retailer has no sales offices in this state. Thus, if the only business location that a retailer has in the state is a stock of goods, that location gets a seller's permit. However, if the retailer has business locations where customers visit to either negotiate sales or make purchases in addition to a warehouse location, the sales locations get seller's permits, and the warehouse location does not.

The seller's permit is crucial as it is the only means the Board has of identifying a business location and of identifying a retailer's place of business for sales tax purposes. The seller's permit provides information concerning business operations, which in turn enables the Board to determine the jurisdictions in which the business operations are located and which schedules will be attached to the sales and use tax return. The schedules determine the method the retailer will use to allocate local sales tax (directly or indirectly) to the different jurisdictions where the retailer is selling tangible personal property.

If the retailer cannot allocate local sales tax to specific retail locations, the Board cannot distribute local sales tax revenue directly to local taxing jurisdictions and indirect allocation through the countywide pool is the only option<sup>7</sup>. Guidelines for allocating local tax are set forth in Exhibit 5 of Chapter 5 of the *Compliance Policy and Procedures Manual* (<http://www.boe.ca.gov/pdf/cpm-05.pdf>). As noted above, Regulation 1699 does not provide for issuing seller's permits to places where only stocks of merchandise are stored and sales are not negotiated.<sup>8</sup>

*c) Which of the retailer's permitized places of business is the "place of sale" for the purpose of allocating the local tax revenues derived from a particular sale?*

Once the retailer's permitized places of business in this state are identified, Regulation 1802 (which interprets and implements RTC section 7205), provides guidance in determining the place of sale. For local tax purposes, retail sales are consummated at the retailer's place of business if the retailer has only one place of business in the state. (RTC § 7205(a).) Otherwise, if the retailer has no permanent place of business, or more than one place of business, sales are consummated as determined under rules and regulations of the Board. (RTC § 7205(b)(1).) Regulation 1802(a) interprets and implements the place of sale rules as follows:

(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

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<sup>7</sup> There are special provisions for direct allocation in certain circumstances where the retailer cannot allocate local sales tax to a specific retail location, such as auctioneers making in the aggregate taxable sales over \$500,000 at a non-permitized auction site (see Compliance Policy and Procedures Manual section 265.30).

<sup>8</sup> If the Board adopts staff's proposal, a conforming amendment to Regulation 1699(a) will be necessary.

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

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.

Regulation 1802(c) further provides that local sales tax is allocated to the place where the sale is deemed to take place under rules of Regulation 1802(a) and (b). Regulation 1802(b)(5), as it currently reads, only provides for direct allocation to a warehouse location if the retailer does not also have permitted sales offices in this state.

#### Current Pool Allocations

Article III, Paragraph B of the agreement for state Administration of Local Sales and Use Taxes provides that when the "place of sale" cannot be identified with a permanent place of business in this State as determined by the Board, the local tax will be allocated in one or two ways by using either a countywide or statewide pool. This would occur for instance when the place of sale changes (vending machines or installed fixtures) or deliveries are made through a local warehouse not requiring registration and no other registered place of business participates in the transaction.

#### Current Issues

There are several local tax reallocation inquiries in the appeals process that involve the warehouse rule, which were placed in abeyance pending the outcome of this issue. In general, the contentions made by the inquiring jurisdictions and their consultants (IJC) 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 IJCs generally argue 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.

Staff believes that resolution of this issue requires a regulation change, just as it did in 1993. Staff's proposed amendments to Regulation 1802 (see Exhibit 1) would extend direct distribution of the local sales tax revenue to the city, county, or city and county where the retailer's stock of tangible personal property is located. Staff proposes no change in the basic rule that if the sale is

## INITIAL DISCUSSION PAPER

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

negotiated in this state the place of sale is where the negotiations take place. (See Reg. 1802(a) & (b)(1-4).)

Staff proposes moving the warehouse rule from its current location in subdivision (b)(5) to a new subdivision (c) to emphasize that the basis for the rule is the location of the retailer's property in this state and not negotiations with the retailer's customers. Staff also proposes rewriting the current language to emphasize that in transactions subject to the warehouse rule, the place of sale has, since the beginning of the local tax system, always been the location of the warehouse. Due to unfortunate drafting in 1993, when the amendments to provide for direct allocation to the warehouse location when the retailer has no sales offices in this state were promulgated, the new language made it appear that the place of sale being at the warehouse location was a new rule. It was not; only the direct distribution was new. There has been some confusion over this issue, and staff proposes to erase that confusion by rewriting the section to match the rule as it has always been.

#### Potential impact due to a change from indirect to direct allocation

Local tax rates are the same statewide. As a result, staff's proposal 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, it would result in the redistribution of the local tax where 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. It could also result in a greater reporting burden on retailers who would have to report to individual cities instead of countywide pools.<sup>9</sup>

Determining the impact on retailers, cities, and counties is difficult to quantify. The Board's registration and local tax allocation programs do not identify the warehouse location or capture instances when sales are fulfilled from in-state warehouses for orders negotiated out of state<sup>10</sup>. Therefore, it is not possible to determine if a retailer has a warehouse unless a permit is issued for the warehouse as specified under Regulation 1802(b)(5). However, based on the best available data available in the Board's records, staff identified a total of 12,278 accounts that met specific criteria, such as accounts with both in-state as well as out-of-state addressees, accounts with specific characteristic codes, and accounts with specific business codes. Staff also identified the accounts that reported local sales tax using the countywide pool method. Based on this analysis in the first three-quarters of 2004, staff estimates its proposal would result in reallocation of \$244.1 million from indirect to direct allocation of local sales taxes.

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<sup>9</sup> For example, in a current local tax appeal (not involving the warehouse rule), a change to direct reporting would cause the retailer to report to eleven jurisdictions instead of eight pools.

<sup>10</sup>The Board's programs do not capture this information as the sales and use tax returns and schedules only provide taxpayers with one line per county pool to report all county pool local tax amounts. These amounts may include combined figures for sales and for use tax. Also, the schedules do not require retailers to separately identify revenues derived from sales negotiated out of state but delivered from the in-state non-permitized warehouses. Therefore, it is not possible to determine the portion of the tax reported by the taxpayer to the county pools that is attributable to orders negotiated out of state and fulfilled by the retailers' in-state non-permitized warehouses. If retailers properly report these amounts, they should all be included lump sum in the pool amounts for each county.

## **INITIAL DISCUSSION PAPER**

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

In addition, the several local tax reallocation inquiries in the appeals process involving the warehouse rule have had the beneficial side effect of identifying specific retailers engaged in transactions subject to sales tax under the warehouse rule. Based on the current status and the amounts in controversy in these cases, staff's proposal would result in the reallocation of approximately \$16.1 million in reported local sales tax from various county pools directly to the individual cities where retailers' warehouses are located.

Staff recommends this change be implemented on a prospective basis. It has traditionally been the Board's policy, when changing accounting methods that affect retailers' tax reporting, to promulgate such changes prospectively. This will provide retailers with the time necessary to make the changes to computer programs and record keeping in order to comply with these amendments. In addition, the Board will need to identify and notify all retailers affected by this change in order to change their coding and provide the proper schedules for allocating the tax.

#### **Summary**

Staff welcomes any comments or suggestions from local governments, retailers and other interested parties. Interested parties are also invited to participate in the interested parties' meeting scheduled for May 10, 2005, in Sacramento.

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

Current as of 04/19/2005

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**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) OUT-OF-STATE RETAILERS WHO MAINTAIN A 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 an out-of-state 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, 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.