



STATE BOARD OF EQUALIZATION

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August 19, 2005

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Executive Director

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the August 31, 2005, Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*.

Action 1 on the Agenda concerns proposed revisions to Regulation 1802, extending direct distribution of local sales tax to the location of the warehouse in cases where the retailer has sales offices in this state, as well as clarifying the existing language and renumbering subdivisions and references to accommodate these changes.

Action 2 on the Agenda concerns the proposed conforming amendments to Regulation 1699, *Permits*. Amendments to Regulation 1699 are **new to this Issue Paper**. As requested by interested parties, staff reconsidered its earlier position to delay amendments to Regulation 1699 and is recommending that conforming amendments to Regulation 1699 be adopted concurrently with the proposed changes to Regulation 1802.

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 input on these issues, and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **August 31, 2005** in Room 121 at the address shown above.

Sincerely,

Randie L. Henry, Deputy Director  
Sales and Use Tax Department

RH: 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, Member's Office, Third District (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 (MIC 71)  
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)  
Ms. Kristine Cazadd (MIC 83)  
Ms. Selvi Stanislaus (MIC 82)  
Mr. Randy Ferris (MIC 82)  
Mr. John Waid (MIC 82)  
Ms. Carole Ruwart (MIC 82)  
Ms. Janice Thurston (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. Rey Obligacion (via e-mail)  
Mr. Todd Gilman (MIC 70)  
Mr. Dave Hayes (MIC 67)  
Mr. Jacob Roper (MIC 86)  
Ms. Freda Orendt (MIC 47)  
Mr. Stephen Rudd (MIC 46)  
Mr. Joseph Young (via e-mail)  
Mr. Jeffrey L. McGuire (MIC 92 and via e-mail)  
Mr. Vic Anderson (MIC 44 and via e-mail)  
Ms. Susanne Buehler (MIC 40)  
Ms. Tina Morin (MIC 42)  
Mr. Larry Bergkamp (via e-mail)  
Mr. Larry Micheli (via e-mail)  
Mr. Robert Buntjer (via e-mail)  
Mr. Geoffrey E. Lyle (MIC 50)  
Ms. Leila Khabbaz (MIC 50)  
Ms. Cecilia Watkins (MIC 50)  
Mr. Peter Horton (MIC 50)

**AGENDA —August 31, 2005 Business Taxes Committee Meeting**  
**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**

<p><b>Action 1 — Extend direct distribution to the location of the warehouse in cases where the retailer has in state sales offices, and clarify existing language</b></p> <p>Proposed Reg. 1802(c)(2)          Agenda page 4          Issue Paper – Staff’s recommendation, Item 1</p> <p>Proposed Reg. 1802(c)(1)          Current Reg. 1802(b)(5), (b)(6), and (b)(7)          Agenda page 3 and 4          Issue Paper – Staff’s recommendation, Item 2</p> <p>Proposed Reg. 1802(c)(1) and (c)(2)          Current Reg. 1802(b)(5), (b)(6), and (b)(7)          Agenda pages 3 and 4          Issue Paper Alternative 2, Items 1 and 2</p> <p>Proposed Reg. 1802(c)(1) and (c)(2)          Current Reg. 1802(b)(5), (b)(6), and (b)(7)          Agenda pages 3 and 4          Issue Paper Alternative 2, Items 1 and 2</p>	<p>Adopt either:</p> <p>1. Staff’s recommendation to amend Regulation 1802, as follows:</p> <p style="padding-left: 40px;">(a) Extend direct distribution of local sales tax revenue to the location of the retailer’s stock of tangible personal property, 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, operative July 1, 2006, and</p> <p style="padding-left: 40px;">(b) Move the subdivision of the current warehouse rule concerning the place of sale for out-of-state retailers that do not have a permanent place of business in California to a new subdivision, and move the operative date of October 1, 1993, to the last sentence within the paragraph, and</p> <p style="padding-left: 40px;">(c) Renumber subdivisions and references to accommodate these changes.</p> <p style="text-align: center;">OR</p> <p>2. The League of California Cities’ (LOCC) alternative, supported by the City of Ontario, to:          Adopt staff’s recommendation, and direct staff to resolve existing appeals on this allocation issue by allowing the proposed regulation to immediately apply to those outstanding appeals.</p> <p style="text-align: center;">OR</p> <p>3. MBIA MuniServices Company’s (MMC) alternative, supported by the Cities of Compton and Stockton, and the County of Sacramento, to:</p> <p style="padding-left: 40px;">(a) Adopt staff’s language in (1)(a) and (1)(c) above but omit the words “Operative July 1, 2006,” and</p> <p style="padding-left: 40px;">(b) Adopt staff’s language in (1)(b) and (1)(c) above but omit the words “Operative October 1, 1993.”</p>
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**AGENDA —August 31, 2005 Business Taxes Committee Meeting**  
**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**

<p><b>Action2 — Conforming amendment to Regulation 1699</b></p> <p>Reg. 1699(a)          Agenda page 5          Issue Paper – staff’s recommendation, Item 3</p> <p>Interested parties provided no alternative language.</p>	<p>Adopt either:</p> <ol style="list-style-type: none"> <li>1. Staff’s recommendation to make a conforming amendment to Regulation 1699(a) to specify that operative July 1, 2006, 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 from which retail sales of such merchandise negotiated out of state are delivered or fulfilled.</li> </ol> <p style="text-align: center;">OR</p> <ol style="list-style-type: none"> <li>2) Make no changes to Regulation 1699(a).</li> </ol>
<p><b>Action 3 – Authorization to Publish</b></p>	<p>Recommend publication of amendments to Regulations 1802 and 1699 as adopted in the above actions.</p> <p>Operative Date:          Staffs proposal and League of California Cities alternative: July 1, 2006.          MBIA MuniServices Company: No Operative dates.</p> <p>Implementation:       30 days following OAL approval</p>

**AGENDA —August 31, 2005 Business Taxes Committee Meeting**  
**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**

Action Item	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento
<p><b>Action 1 - Extend direct distribution to the location of the warehouse in cases where the retailer has in-state sales offices, and clarify existing language</b></p>	<p>Regulation 1802</p> <p><del>(b)(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.</del></p> <p><del>(b)(6) (b)(5)</del> <del>(b)(7) (b)(6)</del></p> <p><u>(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA</u></p> <p><u>(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</u></p>	<p>Agree with staff language, and</p> <p><b>direct staff to resolve outstanding appeals by allowing the proposed regulation to apply to them immediately.</b></p>	<p>Regulation 1802</p> <p><del>(b)(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.</del></p> <p><del>(b)(6) (b)(5)</del> <del>(b)(7) (b)(6)</del></p> <p><u>(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA</u></p> <p><u>(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</u></p>

**AGENDA —August 31, 2005 Business Taxes Committee Meeting**  
**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**

Action Item	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento
	<p>or shipment is made. <b>Operative October 1, 1993</b>, local tax collected by the Board for such sales will be distributed to that city, county, or city and county.</p> <p><u>(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. <b>Operative July 1, 2006</b>, 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.</u></p>		<p>or shipment is made. <del>Operative October 1, 1993</del>, local tax collected by the Board for such sales will be distributed to that city, county, or city and county.</p> <p><u>(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. <del>Operative July 1, 2006</del>, 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.</u></p>

**AGENDA —August 31, 2005 Business Taxes Committee Meeting**  
**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**

Action Item	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento
<p><b>Action 2 - Conforming amendment to Regulation 1699</b></p>	<p>Regulation 1699, <i>Permits</i>  <b>(a) IN GENERAL – NUMBER OF PERMITS REQUIRED</b></p> <p><u>Operative July 1, 2006, permits are required for warehouses or other places at which merchandise is stored and which customers do not customarily visit for the purpose of making purchases and from which retail sales of such merchandise negotiated out of state are delivered or fulfilled.</u></p>	<p>[No language provided. Staff's proposed amendment is new.]</p>	<p>[No language provided. Staff's proposed amendment is new.]</p>

Issue Paper Number **05 - 005**



BOARD OF EQUALIZATION  
**KEY AGENCY ISSUE**

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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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**

### **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 recommends the adoption of proposed amendments to Regulations 1802 and 1699, as follows:

1. Add new subdivision 1802(c)(2) to extend direct distribution of local sales tax revenue to the location 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, there is no participation in the sale by the retailer's permanent place of business in this state, and the sale is fulfilled from the retailer's in-state stock of goods. This subdivision would be operative July 1, 2006.
2. Move current subdivision 1802(b)(5) concerning the place of sale for out-of-state retailers that do not have a permanent place of business in California to 1802(c)(1), and move the operative date of October 1, 1993 to the last sentence within the paragraph to clarify that it applies only to the local tax collected by the Board of Equalization (Board) and distributed directly to the location of the warehouse.
3. Amend subdivision (a) of Regulation 1699, Permits, to conform with the proposed amendments to Regulation 1802.

Staff's proposed amendments to Regulations 1802 and 1699 are attached as Exhibits 3 and 4 respectively. (See Issue Paper pages 8 through 10; and agenda action items 1 through 3.)

### **III. Other Alternatives Considered**

#### **A. Alternative 1**

As proposed by the Revenue and Taxation Policy Committee of the League of California Cities (LOCC) and supported by the City of Ontario, adopt staff's recommendation including the operative date of July 1, 2006, to allow for an adequate transition period. However, direct staff to immediately apply the provisions of proposed subdivision 1802(c)(2), situs allocations, to the outstanding appeal cases that relate to the warehouse rule and are pending with the Board. (See Issue Paper pages 11 through 13; agenda action items 1 and 3; and Exhibits 5 and 6.)

#### **B. Alternative 2**

As proposed by MBIA MuniServices Company (MMC) and supported by the City of Compton, the City of Stockton, and the County of Sacramento, adopt staff's recommendation with the following exceptions:

1. In new subdivision 1802(c)(1), omit the words "Operative October 1, 1993."
2. In new subdivision 1802(c)(2), omit the words "Operative July 1, 2006."

(See Issue Paper pages 13 through 15; agenda action items 1 through 3; and Exhibits 7 through 10.)

A comparison of staff's and interested parties' proposed language is attached as Exhibit 2.

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## IV. Background

Since 1993, Regulation 1802(b)(5) has provided for direct allocation of local sales tax revenue to the location of a stock of goods only when the retailer does not have sales offices located in this state (warehouse rule). However, if the retailer has a sales office in this state and the 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<sup>1</sup>. This policy was formally approved by the Board on June 21, 2001, and is published in Compliance Policy and Procedures Manual (CPPM) Chapter 5, *Returns*. Specifically, Exhibit 5 of CPPM Chapter 5, *Local Tax Allocation Guidelines*, (available at <http://www.boe.ca.gov/pdf/cpm-05.pdf>) provides:

### *Retailers Engaged in Intrastate and Interstate Sales*

Retailers who have sales that occur within California (intrastate sales subject to sales tax) as well as sales that occur outside California (interstate sales subject to use tax) are provided with Schedules B and/or C and instructed to segregate the local tax on intrastate sales from interstate sales. The local sales tax on intrastate sales should be allocated to the sales location where the sale is negotiated (Schedule C or Line B2 of Schedule B), or, if the out-of-state retailer maintains no permanent place of business in California other than a stock of goods, to the warehouse/distribution center from which delivery is made. It should be noted that warehouse/distribution center locations are the direct recipients of local tax only if the out-of-state retailer has no instate sales office. (Emphasis added.)

Additional local tax history is provided in Exhibit 11 of this paper.

## V. Discussion

Meetings were held with interested parties on May 10, 2005 and on June 23, 2005. Representatives from various local governments and consulting firms were in attendance to discuss staff's proposed language. As a result of these discussions, local governments and consulting firms submitted a total of six proposals. In response to these proposals and to interested parties' concerns expressed at the meetings, staff revised the proposed amendments to Regulation 1802 and is recommending amendments to Regulation 1699.

Interested parties are generally in agreement that Regulation 1802 should be amended to clarify the procedure for allocating local tax when a retailer with an in-state sales office has delivered the goods

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<sup>1</sup> The countywide pools are an accounting system that indirectly distributes 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.

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from an in-state warehouse, but the sale was negotiated outside the state without participation by the in-state office. However, interested parties had the following concerns with staff's proposed amendments:

1. The proposed operative date of July 1, 2006, in Regulation 1802(c)(2) would bias the outcome of pending local tax reallocation appeals.

Staff has identified 24 local tax reallocation appeal cases involving the warehouse rule that are currently at different levels of the Board's local tax reallocation appeals process<sup>2</sup> (the inquiring jurisdictions and their consultants (IJC) identified 26 cases, but staff does not believe two of these cases involve the warehouse rule issue). The contention made by the IJCs in these cases is generally 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 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. Action on 15 of these cases was deferred while the Business Taxes Committee process on this issue continues. In addition, staff has identified nine local tax reallocation cases that were previously denied by Board Management where no request for Board hearing was received. Therefore, while these cases could be impacted by the proposed amendments if the affected jurisdictions or their consultants decide to request Board hearings, these cases are not currently pending action by this agency.

The interested parties' concern with the operative date is, to some degree, the possible negative effect of the proposed operative date on the outcome of the pending appeals cases. Some interested parties argue that an operative date is not needed since it could result in the denial of pending requests for reallocations. In particular, they expressed concern that the operative date would reinforce the staff's view that the new provision to Regulation 1802 represents a change in law, whereas in the interested parties' opinion, the proposed language merely clarifies existing rules. Therefore, they propose postponing any amendments to Regulation 1802 until all related appeal cases have been considered on their facts. Another group of interested parties who also views staff's proposed amendments as clarifying existing rules, propose to extend the regulatory amendments to outstanding appeals cases. A third group of interested parties argues the amendments should simply be retroactive.

As staff indicated to interested parties during the BTC process, staff's recommendation to include an operative date in Regulation 1802(c)(2) is not intended to cause rejection of the pending appeals. The BTC process is intended to provide Board Members with information that will enable them to make better-informed decisions on the pending appeal cases. The provisions of Regulation 1807 grant IJCs the right to a Board hearing on local tax allocation appeals and staff is not advocating that this right be removed. The final decisions on the pending appeals cases reside with the Board Members. The proposed amendments to Regulation 1802 should not prevent a jurisdiction from having an impartial hearing of its appeal before the Board.

Staff believes that the current language of Regulation 1802(b)(5) clearly limits the direct allocation of local sales tax revenue to the locations of stocks of goods when the retailer does not have sales offices located in this state. Therefore, staff's proposed amendments impose a new requirement on affected retailers to directly report local sales tax. Accordingly, it is staff's position that pending local tax reallocation appeals should be heard under the existing rules, and the operative date would have no

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<sup>2</sup> While for the purpose of this topic, staff has identified 24 local tax appeals cases that specifically involve the reallocation of the local sales tax from the county wide pools to the location of the warehouse, questions have arisen regarding the number of total inquiries filed by the Inquiring Jurisdictions and their Consultants with the Board. For the period of July 1, 1999 to May 31, 2005, there were 209 cases appealed to Board Management and 13 cases appealed to the Board (see Exhibit 12).

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impact on these cases. The Board Members can make their decision on the pending appeals subsequent to the adoption of the proposed regulation as they have previously done in other cases, which were also placed in abeyance pending other BTC topics.

2. The proposed amendments may be more appropriate for Regulation 1699, Permits, rather than Regulation 1802 since Regulation 1699 provides guidelines for the issuance of seller's permits.

Initially, staff proposed to amend Regulation 1802 and intended to make conforming amendments to Regulation 1699 based on the outcome of the Regulation 1802 BTC process. Some interested parties pointed out that the ability of a retailer to allocate local tax to a particular location is dependent on the ability of the retailer to obtain a seller's permit for that location. Regulation 1699 does not address the issuance of a permit in the specific circumstance where a retailer, who has an in-state office, negotiates the sale out-of-state with no in-state participation, and fulfills the sales from its in-state warehouse. Consequently, interested parties suggested that Regulation 1699 be amended prior to, or instead of, Regulation 1802, to clarify that a permit should be issued to the warehouse location under the warehouse rule. This argument is based on the interested parties' view that staff's proposed amendments are merely to clarify existing law. This position constitutes a change from the interested parties' position in their appeals, in which they contend that the provisions of Regulation 1802, and not those of Regulation 1699, control in this situation. However, it is staff's position that its amendments represent a change in the allocation of the local sales tax rather than a clarification of existing practice. Therefore, the allocation of local tax to the warehouse location of a retailer having an in-state sales office is a policy decision that needs to be made at the local tax level in Regulation 1802.

Staff has reconsidered its earlier decision to delay the amendments and is now recommending that Regulations 1802 and 1699 be revised at the same time.

3. The proposed amendments are not necessary, since the Board recently amended Regulation 1802, and, in the interested parties' view, those amendments were intended to solve this particular warehouse rule issue.

Interested parties have indicated that staff's proposed amendments to Regulation 1802 are declaratory of existing law. That is, the current language of Regulation 1802 allows allocation of local tax to the location of a warehouse even when the retailer has a sales office in California. In particular, interested parties are of the opinion that language added to subdivision 1802(a) in 2003 supports this interpretation. The added language is underlined in the following relevant parts of this subdivision:

(a)(1) Retailers Having One Place of Business. For 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.

(a)(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 sales, the sale occurs in that place of business.

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The amendments to subdivision 1802(a) resulted from a Board decision on September 12, 2002, in a local tax reallocation case commonly referred to as the “Fremont” case. In Fremont, the retailer’s in-state sales office was in the same building as the stock of goods, and the retailer already had a permit for this location. In addition, the stock of goods was used to fulfill sales negotiated at both in-state and out-of-state offices. Since the in-state office did not participate in the sales being considered for the reallocation case, subdivision 1802(a) did not apply. Neither did subdivision (b)(5) apply to the allocation of local tax because the retailer had sales offices in this state. As a result, the local tax revenues generated from the out-of-state sales could not be allocated directly to the location of the warehouse as the petitioner requested. The retailer, however, allocated the tax revenues directly to the location of the warehouse rather than indirectly through the medium of the countywide pool system. The petitioners were protesting the Board’s staff action to reallocate the revenues back through the countywide pools.

Based on the facts presented, the Board concluded that this situation created difficulties for the local jurisdictions and Board staff, since subdivision (a) spoke only to participation in sales by in-state sales offices of the retailer. At the Fremont hearing, the Board focused on the fact that the sales office was in the same building as the stock of goods (called an “integrated facility”). The Board concluded that the local sales tax revenue derived from sales made through the out-of-state sales offices should be allocated to the location of the warehouse from which the property sold was shipped or delivered, because the retailer was already directly allocating local sales tax revenues to the warehouse location for sales made by the sales office in the integrated facility. For those reasons, the Board determined that Regulation 1802 needed to be amended. The Board directed the Department to draft language that would provide for direct allocation of local tax when a warehouse is part of an integrated facility with a sales office, and the warehouse fulfills orders from various sales offices, including the out-of-state sales offices. The Board adopted these amendments in August 2003.

At that time, the interested parties’ interpretation of Regulation 1802 was that the local tax attributable to sales negotiated outside the state, whether through a catalog, the Internet, or 800 number phone sales, should be allocated directly to the in-state location of the warehouse from which the goods were delivered. Interested parties also believed that the warehouse “participated” in these types of transactions regardless of whether or not the warehouse is part of an integrated facility. They further believed that delivery of the property from that facility should be considered sufficient “participation” in the sales negotiations to permit allocation of the local tax directly to the location of the warehouse. Based on these views and the fact that the Board adopted their proposed revisions to Regulation 1802(a) in 2003, the interested parties now conclude that the warehouse is considered a “place of sale” under subdivision 1802(a), even when it is not an integrated facility.

Staff believes that the amendments to subdivision 1802(a) do not allow for direct distribution of local sales tax revenue to the location of the retailer’s stock of tangible personal property 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. The purpose of sales and use tax regulations is to educate and inform taxpayers as to their rights and responsibilities regarding sales and use tax reporting.<sup>3</sup> Nowhere in the documents required by the Administrative Procedures Act (APA) does the Board declare that it is changing the rule applicable to sales subject to the warehouse rule and requiring out-of-state retailers to obtain permits for all locations of stocks of goods that fulfill sales negotiated out-of-state, whether or not the retailer has an in-state sales office. The language of subdivision (b)(5) remained unchanged, and the Board declared it was making no fundamental changes to the allocation rules. Staff thus disagrees with

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<sup>3</sup> Sales and Use Tax Regulations, including Regulation 1802, are not directed to cities but to taxpayers and retailers collecting use tax.

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the interested parties' view that the facts in Fremont render staff's current proposed amendments to Regulation 1802 declaratory of existing law.<sup>4</sup>

The adoption of amendments to subdivision 1802(a) in 2003 did not substantively change the Board's interpretation of "place of sale." Under the Bradley-Burns Uniform Local Sales and Use Tax Law section 7205, "place of sale" means that all retail sales are consummated at the place of business of the retailer, 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. In the event a retailer has no permanent place of business in the state or has more than one place of business, the "place of sale" is the place or places at which the retail sales are consummated.

In interpreting section 7205, it has been the Board's longstanding position that for the purpose of determining place of sale under Regulation 1802, a "place of sale" is a business location that can be issued a permit under Regulation 1699. Under Regulation 1699, a "place of business" is one that customers visit to negotiate sales, not one that merely stores and delivers property. Therefore, under the provisions of 1802, a warehouse is normally not considered a "place of sale" since no negotiations take place at the facility. Local tax attributable to out-of-state catalog, Internet, or 800 number phone sales negotiated out-of-state is allocated indirectly through the countywide pool, since the in-state warehouse does not participate in the negotiations. Accordingly, staff believes that an amendment needs to be made to Regulation 1699 for clarification and conformity to the proposed changes to Regulation 1802.

Interested parties also believe staff's proposed language is declaratory of existing law based on subdivision 1802(b)(5). They believe this subdivision already allows the Board to allocate local sales tax directly to the location of the warehouse even if an in-state sales office does not participate in the sale. Staff disagrees with interested parties and believes that the plain language of the regulation allows allocation of local tax to the location of the warehouse only if the retailer has no in-state sales offices.

4. There is no apparent reason for moving the current 1802(b)(5) to (c)(1) or for moving the existing operative date of October 1, 1993 within the paragraph.

An interested party was skeptical of the need to move this subdivision to new subdivision (c)(1), since the change does not clarify current subdivision 1802(b)(5). Rather, the party feels it would only confuse the language further by imposing an operative date of October 1, 1993 on the direct distribution of sales tax revenue on deliveries governed by this subdivision.

Staff explained the proposed move does not change the basic rule that if the sale is negotiated in this state, the place of sale is where the negotiations take place. (See Reg. 1802(a) & (b)(1-4).) However, 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 the 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, the new language amending subdivision 1802(b)(5) made it appear that making the warehouse location the place of sale was a new rule. In fact, only the direct distribution was new.

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<sup>4</sup> The fact that the debate exists demonstrates that the Board did not state that it was changing the rules. Had the Board intended to change the rule, it would have been required to say so by the APA so that the public affected by the change could comment on the proposal.

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5. The staff estimate of the local tax revenues that would need to be redistributed among jurisdictions should the proposed amendments be adopted on a retroactive basis, as well as staff's assessment of the impact on taxpayers, may be overstated.

In its initial discussion paper, staff estimated its proposal would result in the reallocation of up to \$244.1 million (using reported figures from the first three quarters of 2004), from indirect to direct allocation of local sales taxes. Interested parties expressed concerns that the \$244.1 million estimate is overstated. There was more consensus that an estimated \$16.1 million<sup>5</sup> in previously reported local sales tax could be reallocated from various county pools directly to the individual cities if staff's proposed amendment is adopted retroactively. The lower amount was compiled from the outstanding local tax reallocation inquiries in the appeals process involving the warehouse rule. The higher amount is derived from a review of those retailers who currently file Schedule B with their sales and use tax return and whose reported information indicates that their transactions may be covered by the proposed amendments. Staff believes much of the difference between the \$244.1 million and the \$16.1 million represents the local sales tax reported by retailers in compliance with existing rules and distributed by the Board to jurisdictions that are in agreement with the Board's current allocation rules and that have not protested the local tax allocation.

Including an operative date in staff's proposal has neutral revenue effect on returns filed by taxpayers, as well as on outstanding local appeal cases involving the warehouse rule. In other words, the local sales tax that was allocated to cities and counties using the countywide pool system would not need to come out of the future revenues from these jurisdictions for redistribution to the jurisdiction of the warehouse.

Some of the interested parties also believed that an amendment without an operative date would have minimal impact on retailers.

Without an operative date, the proposed amendments to Regulations 1699 and 1802 would be implemented retroactively. Staff believes a retroactive amendment would place an undue administrative burden on taxpayers (in-state and out-of-state retailers) with unregistered warehouses. First, although it would take some time to implement the change, the rule as to returns not yet due would go into effect immediately with no warning to the retailers subject to them. Until staff could notify retailers and issue new schedules and returns, retailers whose sales are subject to the warehouse rule would continue to report tax as the Board has advised them to do for almost fifty years, thus creating numerous mis-allocation situations that would have to be corrected at great expense to taxpayers, the Board, and the local tax jurisdictions. Second, these taxpayers would be required to file amended returns for the last three quarters to reallocate the local tax based on the jurisdiction where the warehouse is located. These adjustments will require retailers to go back in their records and determine the amounts that need to be reallocated to the warehouse jurisdiction under the new rule.<sup>6</sup> At the same time, the retroactive effect of the proposed amendments could potentially create a large increase in the number of appeals filed by consultants on behalf of local jurisdictions who would benefit from the retroactive amendments.

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<sup>5</sup> The \$16.1 million was estimated based on 16 outstanding cases. However, there may be 9 more cases for which numbers will not be available until cases are completely investigated by Board staff.

<sup>6</sup> Since taxpayers are not required to substantiate on their returns their reasons for reporting local sales and use tax indirectly on Schedule B, the amounts reported on Schedule B reflect only the amount of tax, not the reason therefor. Retailers have not heretofore been required to maintain records that specify why tax is reported indirectly. Therefore, they may not have maintained easy access to such records and may have to reconstruct them.

Issue Paper Number: 05 - 005

## VI. Staff Recommendation

### A. Description of the 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) as follows:

(c) Transactions Negotiated Out of State and Delivered from the Retailer's 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.

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.

Subdivision (c)(2) would add language concerning the place of sale by in-state and out-of-state retailers 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 fulfilled 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.

- 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).

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- Amend Regulation 1699, subdivision (a) to conform with proposed amendments to Regulation 1802 as follows:

(a) In General – Number of Permits Required.

...

Operative July 1, 2006, permits are required for warehouses or other places at which merchandise is stored and which customers do not customarily visit for the purpose of making purchases and from which retail sales of such merchandise negotiated out of state are delivered or fulfilled.

Staff's proposed amendments to Regulation 1802 and Regulation 1699 are attached as Exhibit 3 and 4 respectively.<sup>7</sup>

### **B. Pros of the Staff Recommendation**

- The amendments will provide for distribution of local tax revenue directly to the jurisdictions that bear the primary financial burden for providing municipal services, such as police and fire protection, infrastructure, maintenance, and street cleaning due to the warehouse operation.
- A prospective operative date will provide adequate time for the Board to identify and notify all retailers affected by this change, revise retailers' tax codes to ensure that the local tax is allocated to the warehouse location and not the county wide pool, and provide retailers schedules for properly allocating the local tax.
- A prospective operative date will provide retailers with the time necessary to make the changes to computer programs and record keeping systems in order to comply with the new reporting requirements.
- A prospective operative date will ensure that jurisdictions benefit from a consistent interpretation of Board rules and can help them plan future revenue generating activities without a reduction of their previously received and spent revenues.
- The amendment will result in increased revenues to jurisdictions in which warehouses that fulfill orders negotiated out of state are located.

### **C. Cons of the Staff Recommendation**

- Will result in future revenue loss to participants in the countywide pool when the local tax is allocated directly to the city where the warehouse is located.
- The new permit requirement will result in a greater reporting burden for retailers. Depending on the number and the location of the warehouses, retailers may have to report directly to a selection of 479 cities, 58 counties and 40 redevelopment agencies, in addition to the 58 countywide pools, rather than from a selection of only 58 countywide pools.

### **D. Statutory or Regulatory Change**

No statutory change is needed. However, the recommendation will require amendment of Regulation 1802 and a conforming amendment to Regulation 1699.

### **E. Administrative Impact**

Staff will be required to notify taxpayers of the amendments to regulations 1802 and 1699 through an article in the Tax Information Bulletin (TIB) and a special notice to the cities and counties. In

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<sup>7</sup> Once the amendments to Regulations 1802 and Regulation 1699 are in place, Exhibit 5 to Chapter 5 of the CPPM will be updated to reflect the new rule.

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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. Moreover, appropriate revisions must be made to Publication 28, "Tax Information for City and County Officials," to Exhibit 5, *Local Tax Allocation Guidelines*, of CPPM Chapter 5, and to various sections in the Business Taxes Code Book (BTCB) when this regulation is approved by the Office of Administrative Law.

## **F. Fiscal Impact**

### **1. Cost Impact**

- The workload associated with publishing the regulations, TIB article, Publication 28, and the BTCB is considered routine and any corresponding cost would be absorbed within the Board's existing budget.
- A one-page special notice will be sent to affected taxpayers. Staff estimates 12,278<sup>8</sup> accounts are affected. The cost to draft the notice is considered routine and would be absorbed within the Board's existing budget.

### **2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

## **G. Taxpayer/Customer Impact**

Impact on the Retailers: Affected retailers will need to register their warehouse locations and file different allocation schedules with their returns. They will also need to segregate their records and determine the amounts that need to be allocated to the warehouse jurisdiction under the new rule starting with the operative date.

## **H. Critical Time Frames**

An operative date of July 1, 2006 is recommended. The regulation will become effective 30 days after approval by the Office of Administrative Law.

# **VII. Alternative 1**

## **A. Description of the Alternative**

The Revenue and Taxation Policy Committee of the League of California Cities (LOCC) supports staff's amendments to Regulation 1802. In addition, the LOCC proposes to include language making the regulatory change declaratory of existing law, thereby allowing the proposed regulatory provisions to apply to the warehouse rule appeals currently pending with the Board. Moreover, LOCC supports the prospective start date of July 1, 2006, to allow for an adequate transition period.

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<sup>8</sup> This total includes accounts that meet all the following criteria: the account had both in-state and out-of-state addressees, the account had certain characteristic codes, and the account was assigned a business code that could be affected by a change in the warehouse rule.

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Staff contacted Ms. Jean Flournoy Korinke, Legislative Representative of the LOCC, concerning the specific language proposed for the suggestion that staff's proposed amendments be considered declaratory of existing law. Ms. Korinke clarified that LOCC had no specific proposed language for Regulation 1802. LOCC wants the pending cases on this issue cleared and recommends support of the situs allocation effected by the proposed regulation change. Therefore, LOCC indicated it favors a directive from the Board to staff requiring resolution of outstanding appeals through the application of staff's proposed regulatory language.

The LOCC proposed this approach as a way to implement a situs based policy they have always supported. Further, they believe their proposal will immediately resolve the appeals regarding this issue that have been pending with the Board, and the operative date of July 1, 2006 will allow transition time for the cities, the taxpayers, and the Board to adjust to the impact of this change going forward.

In addition to LOCC, the City of Ontario (Ontario) supports staff's recommendation and intent to allocate the local tax sales revenues by situs to the single jurisdiction where the warehouse is located, in cases where the retailer has a sales office in this state but the sales are negotiated out of state. However, Ontario reiterated its belief that Regulations 1802 and 1699 already support allocation to situs and, therefore, there is no need to have the regulations changed. Further, they believe that the recent change to Regulation 1802(a) resulting from the Fremont case accomplished the change to the "warehouse rule" that would allow for direct allocation to situs.

Ontario had originally indicated in their proposal that the Board should first amend Regulation 1699 as it involves the issuing of permits. However, subsequent communication with Mr. Grant Yee, Administrative Services/ Finance Director for Ontario clarified that:

- Ontario supports LOCC's proposal, and
- Ontario is in favor of changing both Regulations 1699 and 1802, but is not concerned which is done first provided the changes are consistent and do not create further problems. Also, they indicated that they would like to review staff's conforming amendments to Regulation 1699.

As previously stated, staff reconsidered its earlier position to delay amendments to Regulation 1699 and is recommending that conforming amendments to Regulation 1699 be adopted concurrently with the proposed changes to Regulation 1802. Staff's proposed amendments to Regulation 1699 are illustrated in Exhibit 4.

## **B. Pros of the Alternative**

- Same as the pros listed under the staff recommendation.
- Will apply direct allocation to local tax appeal cases that have been filed under this issue.

## **C. Cons of the Alternative**

- Same as the cons listed under the staff recommendation.
- Applying the proposed amendments to outstanding appeal cases that relate to this issue could be perceived as giving preference to those cities that previously filed inquiries requesting an interpretation differing from staff's consistent application of existing regulations.

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- Applying the proposed amendments to outstanding appeals will result in revenue losses to jurisdictions that already received and spent tax revenues allocated to them through the countywide pool in the past.

**D. Statutory or Regulatory Change**

Same as staff's recommendation.

**E. Administrative Impact**

Same as staff's recommendation.

In addition, applying the proposed amendments to outstanding appeal cases will require notification of affected jurisdictions. Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*, requires that any jurisdiction losing 5% of their average quarterly allocation (generally, the prior four calendar quarters) or \$50,000, whichever is less, be informed of the Board's decision to reallocate local tax and be allowed 30 days to contact staff to discuss the proposed reallocation.

**F. Fiscal Impact**

**1. Cost Impact**

Same as staff's recommendation.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).<sup>9</sup>

**G. Taxpayer/Customer Impact**

- Impact on the Retailers: Same as staff's recommendation.
- Impact on the Jurisdictions: Applying the proposed amendments to outstanding appeal cases will result in the redistribution of the local tax. Tax gained by the jurisdiction where the warehouse is located is tax lost by the other jurisdictions in the county's pool.

**H. Critical Time Frames**

Same as staff's recommendation.

**VIII. Alternative 2**

**A. Description of the Alternative**

MBIA MuniServices Company (MMC) generally agrees with staff's proposed language provided the operative dates are removed in subdivisions 1802(c)(1) and (2), such that the amendments are declaratory of existing law. MMC proposes the following alternative language:

(c) Transactions Negotiated Out of state and Delivered from the Retailers' Stock of Tangible Personal Property in California

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<sup>9</sup> While taxpayers will not be required to pay additional tax, revenue will be moved from the countywide pools to the jurisdictions where the warehouses are located, resulting in a revenue loss for many jurisdictions and a revenue gain for individual cities.

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(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. 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. 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.

MMC believes the operative date of October 1, 1993 in proposed subdivision 1802(c)(1) is obsolete and should be deleted. In addition, MMC believes the operative date adopted in 1993 was "ineffectual" and the regulatory language adopted at that time affirmed and did not change the controlling provisions of subdivisions 1802(b)(5) and 1699(a).

MMC opposes the July 1, 2006 operative date proposed in the staff recommendation and believes the proposed language should apply retroactively. MMC asserts subdivision 1802(a)(2) is already sufficient to determine the allocation of tax in those instances where an out-of-state retailer with an in-state office ships goods from a warehouse located in the state and the sales negotiations are conducted outside the state. MMC's full submission is attached as Exhibit 9.

## **B. Pros of the Alternative**

- Will provide for distribution of the local tax revenue directly to the jurisdictions where the warehouse is located.

## **C. Cons of the Alternative**

- As a result of the lack of an operative date in subdivision (c)(2), the Board will not have adequate time to identify and notify affected retailers and revise their local tax codes to provide them with the correct tax return schedules to properly allocate the local tax.
- As a result of the lack of an operative date in subdivision (c)(2), retailers will not have adequate time to make the changes to computer programs and record keeping systems in order to comply with the new reporting requirements. Until such changes can be made, retailers will continue to file returns under the current rule.
- Without an operative date in subdivision (c)(2), there would be no transition time for the jurisdictions and the Board to properly identify the taxpayers with unpermitted warehouses. This could result in additional mis-allocation of local taxes.
- Applying the proposed amendments to outstanding appeals will result in revenue losses to jurisdictions that already received and spent tax revenues allocated to them through the countywide pool in the past.
- Applying the proposed amendments to outstanding appeal cases that relate to this issue could be perceived as giving preference to those cities that previously filed inquiries requesting an interpretation differing from staff's consistent application of existing regulations.

Issue Paper Number: **05 - 005**

**D. Statutory or Regulatory Change**

Same as staff's recommendation.

**E. Administrative Impact**

Same as staff's recommendation.

In addition, applying the proposed amendments to outstanding appeal cases will require notification of affected jurisdictions. Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*, requires that any jurisdiction losing 5% of their average quarterly allocation (generally, the prior four calendar quarters) or \$50,000, whichever is less, be informed of the Board's decision to reallocate local tax and be allowed 30 days to contact staff to discuss the proposed reallocation.

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. Until such notification is done, since retailers would continue to report tax under the prior rule, staff will need to correct numerous mis-allocation situations that could occur for retailers whose sales are subject to the warehouse rule.

**F. Fiscal Impact**

**1. Cost Impact**

Same as staff's recommendation.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

**G. Taxpayer/Customer Impact**

Impact on the Retailers: May require taxpayers (in-state and out-of-state retailers) with unregistered warehouses to make certain retroactive adjustments:

- Affected retailers may need to file amended returns for the last three quarters to reallocate the local tax based on the jurisdiction where the warehouse is located<sup>10</sup>.
- For outstanding appeals, some taxpayers may need to segregate their sales to properly report the local tax for sales from the warehouse location. For older appeals cases with open statutes of limitation, the segregation may need to go back 10 years or longer.

In addition, the new rule could affect future return periods. Under this Alternative, allocation to the location of the warehouse will be effective upon approval of the amendment. There is generally a lag time between the approval of an amendment and the notification of the retailers. Accordingly, retailers would continue to report tax under the prior rule until notified of the change. As a result, taxpayers with sales subject to the warehouse rule may need to work with Board staff to correct any mis-allocations that could occur.

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<sup>10</sup> RTC section 7209 provides: "The board may redistribute tax, penalty and interest distributed to a county or city other than the county of city entitled thereto but such redistribution shall not be made as to amounts originally distributed earlier than two quarterly periods prior to the quarterly period in which the board obtains knowledge of the improper distribution.

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Impact on the Jurisdictions: Applying the proposed amendments to outstanding appeal cases will result in the redistribution of the local tax. Any tax gained by a city or county will be at the expense of the other jurisdictions participating in the county-wide pool. It may result in a shift of revenues for up to 10 years or longer for older appeal cases.

#### **H. Critical Time Frames**

None. The regulation will become effective 30 days after approval by the Office of Administrative Law.

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: August 15, 2005

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

<b>Description</b>	<b>Exhibit No.</b>
Revenue Estimate	Exhibit 1
Regulation 1802 – Comparison Table	Exhibit 2
Regulation 1802 – Proposed Amendments	Exhibit 3
Regulation 1699 – Proposed Amendments	Exhibit 4
Submission from the League of California Cities (LOCC)	Exhibit 5
Submission from the City of Ontario	Exhibit 6
Submission from the County of Sacramento	Exhibit 7
Submission from the City of Stockton	Exhibit 8
Submission from MBIA MuniServices Co. (MMC)	Exhibit 9
Submission from the City of Compton	Exhibit 10
Local Tax History	Exhibit 11
General Statistics for Local Tax Reallocation Inquiries	Exhibit 12

**REVENUE ESTIMATE**

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION



**REGULATION 1802, PLACE OF SALE AND USE FOR  
PURPOSES OF BRADLEY-BURNS UNIFORM LOCAL SALES  
AND USE TAX - WAREHOUSE RULE ISSUE**

**Staff Recommendation**

Staff recommends the adoption of proposed amendments to Regulations 1802 and 1699, as follows:

1. Add new subdivision 1802(c)(2) to extend direct distribution of local sales tax revenue to the location 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, there is no participation in the sale by the retailer's permanent place of business in this state, and the sale is fulfilled from the retailer's in-state stock of goods. This subdivision would be operative July 1, 2006.
2. Move current subdivision 1802(b)(5) concerning the place of sale for out-of-state retailers that do not have a permanent place of business in California to 1802(c)(1), and move the operative date of October 1, 1993 to the last sentence within the paragraph to clarify that it applies only to the local tax collected by the Board of Equalization (Board) and distributed directly to the location of the warehouse.
3. Amend subdivision (a) of Regulation 1699, Permits, to conform with the proposed amendments to Regulation 1802.

**Other Alternative(s) Considered**

**Alternative 1**

As proposed by the Revenue and Taxation Policy Committee of the League of California Cities (LOCC) and supported by the City of Ontario, adopt staff's recommendation including the operative date of July 1, 2006, to allow for an adequate transition period. However, direct staff to

Revenue Estimate

immediately apply the provisions of proposed subdivision 1802(c)(2), situs allocations, to the outstanding appeal cases that relate to the warehouse rule and are pending with the Board.

**Alternative 2**

As proposed by MBIA MuniServices Company (MMC) and supported by the City of Compton, the City of Stockton, and the County of Sacramento, adopt staff's recommendation with the following exceptions:

1. In new subdivision 1802(c)(1), omit the words "Operative October 1, 1993."
2. In new subdivision 1802(c)(2), omit the words "Operative July 1, 2006."

**Background, Methodology, and Assumptions**

**Staff Recommendation:**

There is nothing in the proposed amendment subdivision to Regulation 1802 or Regulation 1699 that would either increase or decrease revenues because the proposals define rules for the allocation of existing local sales and use tax receipts specific to purchase transactions negotiated out of state which involve the delivery of products through warehouses located within the state. There would, however, be a shift of revenues between local jurisdictions.

**Alternative 1:**

Alternative 1 would not impact total revenues, since whether the regulatory change immediately applies to existing appeal cases, or applies prospectively, there would still not be any increase or decrease in revenue. However, there would be a shift of revenues between local jurisdictions.

**Alternative 2:**

Alternative 2 would not impact total revenues, however, there would be a shift of revenues between local jurisdictions.

**Revenue Summary**

The staff recommendation will not impact total revenues, but will result in a shift of revenues between local jurisdictions.

The alternative proposals will not impact total revenues, but will result in a shift of revenues between local jurisdictions.

**Preparation**

Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative and Research Division, and Mr. Jeff McGuire, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue  
Comparison of Current and Proposed Language**

Current as of August 10, 2005

Action Item	Current Regulatory Language	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento	Summary Comments
<b>ACTION 1 -</b>					
Extend direct distribution to the location of the warehouse in cases where the retailer has in-state sales offices, and clarify existing language	<p>Regulation 1802</p> <p>(b)(5) OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA.</p> <p>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.</p> <p>(b)(6) (b)(7) 1802(c)</p>	<p>Regulation 1802</p> <p><del>(b)(5) OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA.</del></p> <p><del>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.</del></p> <p>(b)(5) (b)(6) 1802(d)</p>	<p>Regulation 1802</p> <p><del>(b)(5) OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA.</del></p> <p><del>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.</del></p> <p>(b)(5) (b)(6) 1802(d)</p>	<p>Regulation 1802</p> <p><del>(b)(5) OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA.</del></p> <p><del>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.</del></p> <p>(b)(5) (b)(6) 1802(d)</p>	<p>Move current subdivision 1802(b)(5) to new subdivision (c)(1).</p> <p>Renumber current subdivision 1802(c), as 1802(d), and current subdivisions 1802(b)(6) and (7) as 1802(b)(5) and (6) respectively.</p>

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue  
Comparison of Current and Proposed Language**

Current as of August 9, 2005

Action Item	Current Regulatory Language	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento	Summary Comments
Action 1- continuation	None	<p><u>(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA</u>  <u>(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.</u>  <b><u>Operative October 1, 1993,</u></b> local tax collected by the Board for such sales will be distributed to that city, county, or city and county.</p>	<p><u>(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA</u>  <u>(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.</u>  <b><u>Operative October 1, 1993,</u></b> local tax collected by the Board for such sales will be distributed to that city, county, or city and county.</p>	<p><u>(c) TRANSACTIONS NEGOTIATED OUT OF STATE AND DELIVERED FROM THE RETAILERS' STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA</u>  <u>(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. Local tax collected by the Board for such sales will be distributed to that city, county, or city and county.</u></p>	<p>Move the operative date of October 1, 1993 to the last sentence within the paragraph.</p> <p>MMC believes the operative date is obsolete and should be omitted.</p>

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**  
**Comparison of Current and Proposed Language**  
 Current as of August 9, 2005

Action Item	Current Regulatory Language	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento	Summary Comments
Action 1 - continuation		<p><u>(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.</u></p>	<p><u>(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.</u></p>	<p><u>(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. 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.</u></p>	<p>(c)(2) Extend direct distribution of local sales tax revenue to the location of the retailer's stock of tangible personal property, 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, operative July 1, 2006,</p> <p>MMC agrees with staffs proposed language but omit the "Operative July 1, 2006" to make the amendments declaratory of existing law.</p> <p>LOCC supports staff's language but direct staff to immediately apply the proposed subdivision 1802(c)(2), situs allocations, to the outstanding cases.</p>

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**  
**Comparison of Current and Proposed Language**  
 Current as of August 9, 2005

Action Item	Current Regulatory Language	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento	Summary Comments
<b>Action 2 -</b>					
Conforming amendment to Regulation 1699	<p><b>(a) IN GENERAL – NUMBER OF PERMITS REQUIRED.</b>                      Every person engaged in the business of selling (or leasing under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) 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</p>	<p><b>(b) IN GENERAL – NUMBER OF PERMITS REQUIRED.</b>                      Every person engaged in the business of selling (or leasing under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) 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</p>	No language provided. Staff's proposed amendment is new.	No language provided. Staff's proposed amendment is new.	Make a conforming amendment to Regulation 1699(a) to specify that operative July 1, 2006, 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 from which retail sales of such merchandise negotiated out-of-state are delivered or fulfilled.

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**  
**Comparison of Current and Proposed Language**  
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Action Item	Current Regulatory Language	Regulatory Language Proposed by Staff	Regulatory Language Proposed by the LOCC and supported by the City of Ontario	Regulatory Language Proposed by MMC and supported by the Cities of Compton and Stockton, and the County of Sacramento	Summary Comments
Continuation - Action 2	<p>customarily taken and contracts negotiated, whether or not merchandise is stocked there.</p> <p>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.</p>	<p>customarily taken and contracts negotiated, whether or not merchandise is stocked there.</p> <p>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.</p> <p><u>Operative July 1, 2006, permits are required for warehouses or other places at which merchandise is stored and</u></p>			

**Regulation 1802, Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes – Warehouse Rule Issue**  
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Continuation - Action 2	<p>If two or more activities are conducted by the same person on the same premises, even though in different buildings, only one permit is required.                      For example:                      A service station operator having a restaurant in addition to the station on the same premises requires only one permit for both activities.</p>	<p><u>which customers do not customarily visit for the purpose of making purchases and from which retail sales of such merchandise negotiated out of state are delivered or fulfilled.</u></p> <p>If two or more activities are conducted by the same person on the same premises, even though in different buildings, only one permit is required.                      For example:                      A service station operator having a restaurant in addition to the station on the same premises requires only one permit for both activities.</p>			

**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, 7203.1, 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 (ed) 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 RETAILER'S 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.

## Regulation 1699. PERMITS

References: Sections 6066-6075, Revenue and Taxation Code.

**(a) IN GENERAL – NUMBER OF PERMITS REQUIRED.** Every person engaged in the business of selling (or leasing under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) 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.

Operative July 1, 2006, permits are required for warehouses or other places at which merchandise is stored and which customers do not customarily visit for the purpose of making purchases and from which retail sales of such merchandise negotiated out of state are delivered or fulfilled.

If two or more activities are conducted by the same person on the same premises, even though in different buildings, only one permit is required. For example:

A service station operator having a restaurant in addition to the station on the same premises requires only one permit for both activities.

**(b) PERSONS SELLING IN INTERSTATE COMMERCE OR TO UNITED STATES GOVERNMENT.** A permit is not required to be held by persons all of whose sales are made exclusively in interstate or foreign commerce but a permit is required of persons notwithstanding all their sales (or leases under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) are made to the United States or instrumentalities thereof.

**(c) PERSONS SELLING FEED.** Effective April 1, 1996, a permit is not required to be held by persons whose sales consist entirely of sales of feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption (food animals), or for any form of animal life not of such a kind (nonfood animals) which are being held for sale in the regular course of business, provided no other retail sales of tangible personal property are made.

If a seller of hay is also the grower of the hay, this exemption shall apply only if either:

1. The hay is produced for sale only to beef cattle feedlots or dairies, or
2. The hay is sold exclusively through a farmer-owned cooperative.

**(d) CONCESSIONAIRES.** For the purposes of this regulation, the term concessionaire is defined as an independent retailer who is authorized, through contract with, or permission of, another retail business enterprise (the prime retailer), to operate within the perimeter of the prime retailer's own retail business premises, which to all intents and purposes appear to be wholly under the control of that prime retailer, and to make retail sales that to the general public might reasonably be believed to be the transactions of the prime retailer. Some indicators that a retailer is *not* operating as a concessionaire are that he or she:

- Appears to the public to be a business separate and autonomous from the prime retailer. Examples of businesses that may appear to be separate and autonomous, while operating within the prime retailer's premises, are those with signs posted on the premises naming each of such businesses, those with separate cash registers, and those with their own receipts or invoices printed with their business name.
- Maintains separate business records, particularly with respect to sales.
- Establishes his or her own selling prices.

- Makes business decisions independently, such as hiring employees or purchasing inventory and supplies.
- Registers as a separate business with other regulatory agencies, such as an agency issuing business licenses, the Employment Development Department, and/or the Secretary of State.
- Deposits funds into a separate account.

In cases where a retailer is not operating as a concessionaire, the prime retailer is *not* liable for any tax liabilities of the retailer operating on his or her premises. However, if a retailer is deemed to be operating as a concessionaire, the prime retailer may be held jointly and severally liable for any sales and use taxes imposed on unreported retail sales made by the concessionaire while operating as a concessionaire. Such a prime retailer will be relieved of his or her obligation for sales and use tax liabilities incurred by such a concessionaire for the period in which the concessionaire holds a permit for the location of the prime retailer or in cases where the prime retailer obtains and retains a written statement that is taken in good faith in which the concessionaire affirms that he or she holds a seller's permit for that location with the Board. The following essential elements must be included in the statement in order to relieve the prime retailer of his or her liability for any unreported tax liabilities incurred by the concessionaire:

- The permit number of the concessionaire
- The location for which the permit is issued (must show the concessionaire's location within the perimeter of the prime retailer's location)
- Signature of the concessionaire
- Date

While any statement, taken timely, in good faith and containing all of these essential elements will relieve a prime retailer of his or her liability for the unreported sales or use taxes of a concessionaire, a suggested format of an acceptable statement is provided as Appendix A to this regulation. While not required, it is suggested that the statement from the concessionaire contain language to clarify which party will be responsible for reporting and remitting the sales and/or use tax due on his or her retail sales.

In instances where the lessor, or grantor of permission to occupy space, is not a retailer himself or herself, he or she is not liable for any sales or use taxes owed by his or her lessee or grantee. In instances where an independent retailer leases space from another retailer, or occupies space by virtue of the granting of permission by another retailer, but does not operate his or her business within the perimeter of the lessor's or grantor's own retail business, such an independent retailer is not a concessionaire within the meaning of this regulation. In this case, the lessor or grantor is not liable for any sales or use taxes owed by the lessee or grantee.

**(e) AGENTS.** If agents make sales on behalf of a principal and do not have a fixed place of business, but travel from house to house or from town to town, it is unnecessary that a permit be obtained for each agent if the principal obtains a permit for each place of business located in California. If, however, the principal does not obtain a permit for each place of business located in California, it is necessary for each agent to obtain a permit.

**(f) INACTIVE PERMITS.** A permit shall be held only by persons actively engaging in or conducting a business as a seller of tangible personal property. Any person not so engaged shall forthwith surrender his or her permit to the Board for cancellation. The Board may revoke the permit of a person found to be not actively engaged in or conducting a business as a seller of tangible personal property.

Upon discontinuing or transferring a business, a permit holder shall promptly notify the Board and deliver his or her permit to the Board for cancellation. To be acceptable, the notice of transfer or discontinuance of a business must be received in one of the following ways:

(1) Oral or written statement to a Board office or authorized representative, accompanied by delivery of the permit, or followed by delivery of the permit upon actual cessation of the business. The permit need not be delivered to the Board, if lost, destroyed or is unavailable for some other acceptable reason, but notice of cessation of business must be given.

(2) Receipt of the transferee or business successor's application for a seller's permit may serve to put the Board on notice of the transferor's cessation of business.

Notice to another state agency of a transfer or cessation of business does not in itself constitute notice to the Board.

Unless the permit holder who transfers the business notifies the Board of the transfer, or delivers the permit to the Board for cancellation, he or she will be liable for taxes, interest and penalties (excluding penalties for fraud or intent to evade the tax) incurred by his or her transferee who with the permit holder's actual or constructive knowledge uses the permit in any way; e.g., by displaying the permit in transferee's place of business, issuing any resale certificates showing the number of the permit thereon, or filing returns in the name of the permit holder or his or her business name and under his or her permit number. Except in the case where, after the transfer, 80 percent or more of the real or ultimate ownership of the business transferred is held by the predecessor, the liability shall be limited to the quarter in which the business is transferred, and the three subsequent quarters.

Stockholders, bondholders, partners, or other persons holding an ownership interest in a corporation or other entity shall be regarded as having the "real or ultimate ownership" of the property of the corporation or other entity.

**(g) DUE DATE OF RETURNS - CLOSEOUT OF ACCOUNT ON YEARLY REPORTING BASIS.** Where a person authorized to file tax returns on a yearly basis transfers the business to another person or discontinues it before the end of the yearly period, a closing return shall be filed with the Board on or before the last day of the month following the close of the calendar quarter in which the business was transferred or discontinued.

**(h) BUYING COMPANIES - GENERAL.**

(1) DEFINITION. For the purpose of this regulation, a buying company is a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services, for the other entity. It is presumed that the buying company is formed for the operational reasons of the entity which owns or controls it or to which it is otherwise related. A buying company formed, however, for the sole purpose of purchasing tangible personal property ex-tax for resale to the entity which owns or controls it or to which it is otherwise related in order to re-direct local sales tax from the location(s) of the vendor(s) to the location of the buying company shall not be recognized as a separate legal entity from the related company on whose behalf it acts for purposes of issuing it a seller's permit. Such a buying company shall not be issued a seller's permit. Sales of tangible personal property to third parties will be regarded as having been made by the entity owning, controlling, or otherwise related to the buying company. A buying company that is not formed for the sole purpose of so re-directing local sales tax shall be recognized as a separate legal entity from the related company on whose behalf it acts for purposes of issuing it a seller's permit. Such a buying company shall be issued a seller's permit and shall be regarded as the seller of tangible personal property it sells or leases.

(2) ELEMENTS. A buying company is not formed for the sole purpose of re-directing local sales tax if it has one or more of the following elements:

(A) Adds a markup to its cost of goods sold in an amount sufficient to cover its operating and overhead expenses.

(B) Issues an invoice or otherwise accounts for the transaction.

The absence of any of these elements is not indicative of a sole purpose to redirect local sales tax.

**(i) WEB SITES.** The location of a computer server on which a web site resides may not be issued a seller's permit for sales tax purposes except when the retailer has a proprietary interest in the server and the activities at that location otherwise qualify for a seller's permit under this regulation.

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July 11, 2005

Mr. Jeffrey McGuire  
Tax Policy Manger, MIC: 92  
Sales and Use Tax Department  
PO Box 942879  
Sacramento, CA 94729-0092

**RE: PROPOSED AMENDMENTS TO REGULATION 1802, PLACE OF SALE AND USE FOR PURPOSES OF BRADLEY-BURNS LOCAL SALES AND USE TAXES**

Dear Mr. McGuire:

I write to inform you that the League of California Cities Revenue and Taxation Policy Committee (Committee) has taken a position on the proposed amendments to Regulation 1802. The Committee's unanimous recommendation has been placed on the League's Board of Directors consent calendar agenda for final action and adoption at the next Board meeting, which is scheduled for late July.

The League's Revenue and Taxation Committee supports the proposed amendment to Regulation 1802 with an amendment to include language that makes the regulatory change declaratory, allowing the proposed regulation to immediately apply to the outstanding appeals related to this issue currently pending with the BOE. The committee supports the prospective start date of July 1, 2006, as proposed by BOE staff for the permanent change to take place, allowing for an adequate transition period.

The Committee settled on this approach as a way to implement a policy we support - situs-based allocation, - in a manner which immediately resolves the appeals that have been pending with the BOE on this issue for some time, and allows for a transition time (until July 1, 2006) for cities to adjust to the impacts of this change going forward. We believe that the existing cases need to be accounted for, and that our proposed declaratory change provides resolution to this issue.

Should you have any questions about the Committee's position, please feel free to contact me at (916) 658-8245. We will keep you updated as the League's Board makes their decision.

Sincerely,

Jean Flournoy Korinke  
Legislative Representative

- cc: The Honorable Betty Yee, State Board of Equalization
- The Honorable Bill Leonard, State Board of Equalization
- The Honorable Claude Parrish, State Board of Equalization
- The Honorable John Chiang, State Board of Equalization
- The Honorable Steve Westly, State Controller, Ex-Officio Member, State Board of Equalization

CITY OF



ONTARIO

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CALIFORNIA 91764-4196

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PAUL S. LEON  
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CITY MANAGERALAN D. WAPNER  
MAYOR PRO TEMMARY E. WIRTES, MMC  
CITY CLERKGERALD A. DUBOIS  
JASON ANDERSON  
SHEILA MAULTZ  
COUNCIL MEMBERS

July 7, 2005

JAMES R. MILHISER  
TREASURER

Mr. Jeffrey L. McGuire, Tax Policy Manager  
Board of Equalization  
450 N Street (MIC:92)  
P.O. Box 942879  
Sacramento, CA 94279-0092

Subject: Proposed Amendments to Regulation 1802  
Business Tax Committee Meeting on June 23, 2005

Dear Mr. McGuire:

After participating at the second Business Tax Committee meeting on June 23, 2005, the City of Ontario is responding to the Board of Equalization's (Board) request for written public comments on the proposed amendments to Regulation 1802 - Place of Sale and Use for Purposes of Bradley-Burns Local Sales and Use Taxes.

The City of Ontario supports the Board Staff's recommendation and intent to allocate the local sales revenue by situs to the single jurisdiction where the warehouse is located, in cases where the retailer has a sales office in this state but the sales are negotiated out of state.

The City, however, does not support the proposed amendments to Regulation 1802 as the approach to resolve this allocation issue for the following reasons:

- First, Regulations (1699 and 1802) currently support the allocation and distribution of the subject revenues by situs to the single jurisdiction where the warehouse is located without changing the current regulations. This is evidenced by the fact the Board is currently using existing language under Regulation 1802(a) to determine the place of sale in the Office Depot case to be the location of the warehouse because it is the only place of business that participates in the sale in the state. If this is not true, what section of Regulation 1802 is the Board Staff using to determine the place of sale in the Office Depot case?
- Second, it appears that the Board Staff's effort to address this area of the law is misdirected. In the City's outstanding appeal matter, Board Staff has cited **Regulation 1699 - Permit** as the reason for denying the City's claim for reallocation - **not Regulation 1802(a) - Place of Sale**. Moreover, Board Staff's position on the Office

Depot case does not apply in the Ontario matter because the Office Depot warehouse location holds a permit. This position confirms that Regulation 1699 is the area of the law in dispute. If the Board Staff is using Regulation 1699 as the basis for prohibiting the allocation of sales tax from a warehouse to a single jurisdiction, this begs the question - why is the Board Staff proposing changes to Regulation 1802 instead of Regulation 1699?

- Moreover, as further confirmation that Regulation 1802 does not require any further changes, Board Staff has already determined based on existing language in Regulation 1802(a) that the place of sale (in the City's appeal matter) is the location of the warehouse in Ontario. This is evidenced by the fact the Board Staff has allocated the local sales tax revenues to the San Bernardino county pool - the county where the Ontario warehouse is located.
- This issue is not about determining the "Place of Sale" under Regulation 1802 - it is about whether a warehouse location can be issued a permit under Regulation 1699 for the purpose of allocating the local sales tax to the single jurisdiction where the warehouse is located instead of the County-wide pool. The City believes that the current language in Regulation 1699 allows warehouse locations (without a sales office) to receive a permit. This is further evidenced by the fact that the Board of Equalization has issued permits to many other similar warehouses (without sales office) throughout the state. If these other warehouse locations are eligible under Regulation 1699 to receive a permit, then the Ontario warehouse location should also receive a permit.
- Finally, the prospective date of July 1, 2006 will negatively impact the City's opportunity for a fair hearing on its pending appeals on this subject. The City is concerned that the Board Staff may use the proposed amendment in its defense against the City in its pending appeals.

### **City Proposed Recommendation**

As a resolution to the concerns expressed by cities with pending appeals on this subject and the Board Staff's concerns regarding potential retroactive appeals if any proposed regulation is considered "declaratory", the City is proposing that only the existing outstanding appeals on this warehouse issue be included as part of any proposed new regulation change (preferably Regulation 1699). This recommendation would also eliminate the need for each appeal matter to be heard by the Board Members.

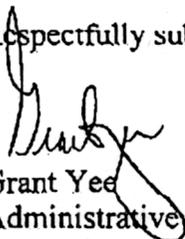
Moreover, at its meeting of June 24, 2005, the League of California Cities' Revenue and Taxation Committee unanimously recommended to its Board Members that the proposed regulation change should include the existing outstanding appeals that have been filed by cities.

The impetus for the proposed amendment and for the Business Tax Committee to review this area of the law came about as a direct result of numerous cities filing appeals on this subject. After waiting many years for their cases to be heard and years of effort, these cities have finally persuaded the Board Staff that the local sales tax revenue should be allocated to the warehouse

location, in cases where the retailer has a sales office in this state but sales are negotiated out of state. To exclude these cities from the proposed amendment or impose a future effective date would simply be wrong and unfair.

In summary, the City appreciates and supports Board Staff's effort to clarify this section of the law but only if this clarification applies to the outstanding appeals filed by cities. In addition, if any changes are proposed to clarify this area of the law, the changes should be reflected in Regulation 1699 – not Regulation 1802.

Respectfully submitted,



Grant Yee  
Administrative Services/ Finance Director

Cc: Chairman Mr. John Chiang  
Vice-Chairman Mr. Claude Parish  
Board Member Mr. Bill Leonard  
Board Member Mr. Steve Westly  
Acting Board Member Ms. Betty Yee

County Executive  
Terry Schutten



County of Sacramento

Board of Supervisors  
Roger Dickinson, District 1  
Illa Collin, District 2  
Susan Peters, District 3  
Roberta MacGlashan, District 4  
Don Nottoli, District 5

June 28, 2005

Ms. Cecilia Watkins  
Program Policy Specialist  
State Board of Equalization  
450 N Street  
Sacramento, CA 95814

***Subject: Proposed Amendments to Board of Equalization Regulation 1802***

Dear Ms. Watkins:

The County of Sacramento is responding to the Board's request for public comment on its Second Issue Paper on proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Local Sales and Use Taxes*.

The County opposes Board Staff effort to amend Regulation 1802 in fairness to more than thirty outstanding appeals or inquiries involving this issue, including one of our own described herein, only with the MBIA MuniServices Reference No. SSOH 98-043004, in order to preserve taxpayer confidentiality. We believe there is "plain language" support in existing Regulation 1699, *Permits*, for requiring registration of these distribution centers, and therefore distribution of the subject revenues by situs to the single jurisdiction where the centers are located without changing the current regulations.

The County does not believe that there is any need, or that it would be fair to jurisdictions that have complied with the dispute resolution process embodied in Regulation 1807(effective January 1, 2003), to revisit this issue in the regulatory process until the pending "lead" appeal dispute has been considered. Also the prospective effective date of July 1, 2006 is not necessary since the language being proposed would only "clarify" what the appealing cities and counties in the pending disputes believe to be the law now, under Regulation 1699 as well as Regulation 1802.

Letter-Cecilia Watkins, State Board of Equalization

June 28, 2005

Page 2 of 2

Exhibit 7

We therefore request that the Board approve clarification language to existing law instead of imposing a "new" regulation.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Terry Schutten", with a long, sweeping horizontal stroke extending to the right.

Terry Schutten

TS:GD:xx

cc: Jean Korinke-Legislative Representative, League of California Cities  
The Honorable Bill Leonard-Member, Board of Equalization, 2<sup>nd</sup> District  
The Honorable John Chiang- Member, Board of Equalization, 4th District

EDWARD J. CHAVEZ  
Mayor

GARY S. GIOVANNETTI  
Vice Mayor  
District 5



2004  
1999



# CITY OF STOCKTON

OFFICE OF THE CITY COUNCIL

CITY HALL • 425 N. El Dorado Street • Stockton, CA 95202-1997  
209/937-8244 • Fax 209/937-8568

STEVE J. BESTOLARIDES  
District 1 *Exhibit 8*

DAN J. CHAPMAN  
District 2

LESLIE BARANCO MARTIN  
District 3

CLEM LEE  
District 4

REBECCA G. NABORS  
District 6

**RECEIVED**

JUL 8 2005

June 28, 2005

Ms. Cecilia Watkins  
State Board of Equalization  
450 N Street  
Sacramento, CA 95814

Via fax 916-322-4530

BUSINESS TAXES COMMITTEE  
AND TRAINING SECTION

## PROPOSED AMENDMENTS TO REGULATION 1802

The City of Stockton is responding to the Board's request for public comment on its Second Issue Paper on proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Local Sales and Use Taxes*.

The City of Stockton opposes Board Staff effort to amend Regulation 1802 in fairness to more than thirty outstanding appeals or inquiries involving this issue, including one of our own described herein only with the MBIA MuniServices Reference No. (REF No. PFS-SZOH 98-036274) in order to preserve taxpayer confidentiality. We believe there is "plain language" support in existing Regulation 1699, *Permits*, for requiring registration of these distribution centers and therefore distribution of the subject revenues by situs to the single jurisdiction where the centers are located without changing the current regulations.

The City of Stockton does not believe that there is any need, or that it would be fair to jurisdictions that have complied with the dispute resolution process embodied in Regulation 1807 (effective January 1, 2003), to revisit this issue in the regulatory process until the pending "lead" appeal dispute has been considered. Also the prospective effective date of July 1, 2006 is not necessary since the language being proposed would only "clarify" what the appealing cities and counties in the pending disputes believe to be the law now, under Regulation 1699 as well as Regulation 1802.

We therefore request that the Board approve clarification language to existing law instead of imposing a 'new' regulation.

A handwritten signature in black ink, appearing to read "Edward J. Chavez".

EDWARD J. CHAVEZ  
MAYOR

cc: Jean Korinke, League of California Cities ([jkorinke@cacities.org](mailto:jkorinke@cacities.org))  
Honorable John Chiang ([cschutz@boe.ca.gov](mailto:cschutz@boe.ca.gov))

**JULY 26, 2005**

**E-MAIL SUBMISSION OF PROPOSED LANGUAGE BY  
MBIA MUNISERVICES Co. (MMC)**

**-----Original Message-----**

*From: Narayan, Brenda MuniServices; Sent: Tuesday, July 26, 2005 1:19 PM*

*To: Watkins, Cecilia; Varney, Janis; Cc: ackoch@sbcglobal.net; Mancina, Fran*

“Cecilia, I am sending the attached on behalf of MMC as proposed changes to Regulation 1802. Please contact one of us if you have any questions or comments.

Brenda

Interested parties are willing to support the Staff amendments only if the sentences containing dates in each subdivision of proposed new subparagraph 1802 (c) are revised to remove both operative dates so that the amendments are declaratory of existing law and read as follows:

(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.”



1037 Suncoast Lane, Suite 110  
El Dorado Hills, CA 95762  
916 939 7700 / 888 370 7200 (p)  
916 939 7752 (f)

July 11, 2005

EXHIBIT 9

Mr. Jeffrey L. McGuire, Tax Policy Manager  
State Board of Equalization  
450 N St. (MIC: 92)  
P. O. Box 942879  
Sacramento, CA 94279-0092

*Re: Second Discussion Paper on Regulation 1802 (June 23, 2005.)*

Dear Mr. McGuire:

This letter responds to the second Discussion Paper on Regulation 1802 that proposes to amend that regulation in two respects. These proposals originated with the Board's Legal Department and are scheduled to be considered by the Business Taxes Committee on August 31, 2005.

Introduction and Summary

The first proposal would delete current Subdivision 1802 (b) (5), shift its language to a new Subdivision 1802 (c) (1) and move the date of October 1, 1993 from its first to the second sentence. This amendment does not have an effective date and, is therefore, apparently intended to "clarify" the meaning of current law.

MBIA MuniServices Co. ("MMC") opposes the first proposal as being an incorrect representation of the original effect of the 1993 amendment to Subdivision 1802 (b) (5). Instead of clarifying current Subdivision 1802 (b) (5), it would only confuse its meaning further by attempting to impose a retrospective effective date of October 1, 1993 on the direct distribution of sales tax revenue on deliveries governed by Subdivision 1802 (b) (5). The need for moving the language to a new Subdivision 1802 (c) (1) is also unclear as no explanation for doing so is provided in either of the two BOE Discussion Papers.

Whether Subdivision 1802 (b) (5) is replaced by Subdivision 1802 (c) (1), the date of October 1, 1993 should be deleted as obsolescent.

The second proposal would adopt a new Subdivision 1802 (c) (2) to require direct distribution of sales tax revenue on deliveries from stocks of goods even where the retailer has other places of business in the state, as long as there is no participation in those transactions by any such place. The Staff is proposing a prospective effective date of July 1, 2006 for this rule.

MMC also opposes the July 1, 2006 effective date contained in Proposed Subdivision 1802 (c) (2) and requests that it be stricken. Otherwise, that date could be interpreted as disapproving some or all of thirty pending inquiry or appeal cases involving the subject issue that MMC has identified that are awaiting Board Member or Staff disposition.

MMC, also opposes this second proposal as duplicating in part the clarification to Regulation 1802 made by the Board Members in 2002 and 2003 by adding Subdivision (a) (2) (A) to Subdivision 1802 (a) (2). Its language was selected as the appropriate clarifying amendment on

December 18, 2002 by the Board Members who had previously decided the Appeal of Fremont (Case ID: No.172019) and was confirmed as the second of two final clarifying amendments by the successor Board on August 3, 2002. It became effective November 28, 2003 after its approval by the Office of Administrative Law.

Adopting the second proposal in its present form as revised in the Second Discussion Paper could confuse the meaning of Subdivision 1802 (a) (2) unnecessarily and also create a negative inference, contrary to Subdivision 1802 (a) (2), that any involvement or "participation," no matter how slight, by another in-state place of business of the taxpayer would prevent the local sales tax revenue from being distributed by situs directly to the jurisdiction where the "consummation" of the sale occurred by direct shipment to the customer from a stock of goods or distribution house..

If an order is negotiated principally out of state and consummated by shipment from an in-state distribution house, the insubstantial participation of another California place of business in that sale should not prevent allocation of the revenue by situs to the place of principal "in state" conduct of the sale in question. To require such a result in all cases presents a real possibility of unintended consequences.

MMC understands that addition of the words, "and there is no participation by the retailer's permanent place of business in this state" in proposed Subdivision 1802 (c) (2) by the Second Discussion Paper was intended to address the issue raised by Mr. Glenn Bystrom in his letter of May 8, 2005. While that letter addresses a valid question, the answer is not entirely clear from the added new language. MMC stands ready to work with Staff and Mr. Bystrom to consider the most effective and clear method for dealing with this legitimate issue.

#### Proposed Subdivision 1802 (c) (1) (Present Subdivision 1802 (b) (5))

The amendment of Regulation 1802 (b) (5) in 1993 changed its wording only slightly and confirmed rather than changed the requirement for direct allocation to the location of the stock of (tangible personal) "property." Prior to October 1, 1993, subdivision (b) (5) of Regulation 1802 read as follows:

**"OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA. If an out-of-state retailer does not have a place of business in this state other than a stock of tangible personal property, the place of sale is the location of the stock of property from which delivery or shipment is made. [Emphasis added.]**

In 1993, the Board added language to subdivision (b) (5) that made the prior meaning more specific by substituting "city, county, or city and county" for "location of the stock of property," added a sentence spelling out the requirement for direct distribution of the revenue as well as a purported effective date at the beginning of the paragraph. The revised language, as adopted by the Board, reads as follows:

*"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.*" (Language in italics added by Board Member vote in February, 1993 went into effect October 1, 1993 following approval by the Office of Administrative Law.)

The above final amendment must be compared with the original two-paragraph amendment proposed by Staff which read as follows:

"OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA. If an out-of-state retailer does not have a permanent place of business in this state other than a stock of merchandise [tangible personal property], the place of sale is the location [of the stock of property] from which delivery or shipment is made. Local tax collected by the Board will be distributed to that city, county, or city and county.

"If the out of state retailer, however, has more than one stock of merchandise located within the state, the place of sale is the county from which delivery or shipment is made. Local tax collected for such sales will be distributed to all local taxing jurisdictions in that county. This place of sale will not be affected by multiple locations of stocks of goods within one taxing jurisdiction." [New language underlined; language in brackets to be stricken.]

Thus, originally, the first paragraph contained no purported effective date, even though its intent was to provide situs allocation to the location of the stock of tangible personal property. At the public hearing on the Board Staff proposal in February of 1993, virtually unanimous public comment favored adoption of the first paragraph in the Staff proposal and deletion of the second. In fact, that is the version of the final amendment that the Board Members adopted, except that the date of October 1, 1993 was added at the beginning of the first sentence of the second paragraph and the proposal to replace the words "tangible personal property" with the word "merchandise" was dropped.

(Parenthetically, it should be pointed out that the two major remaining disputes regarding the pre-1993 meaning of Subdivision 1802 (b) (5) involve taxpayers that had more than one point of distribution in California. The stricken second paragraph of the Staff's original proposal for amending that subdivision would have required county pooling of all local sales tax incurred by these taxpayers. Clearly its deletion supports direct allocation and distribution in those appeals, unless pooling is required by the changes to the remaining first paragraph. But, as will be demonstrated, the meaning and effect of revised Subdivision 1802 (b) (5) was the same before, as well as after the 1993 changes.)

In comparison, all of the pre-existing provisions of subdivisions (a) and (b) of Regulation 1802 provided for allocation of local sales taxes to the "place of business" or "place of sale." For example, at that time, Subdivision 1802 (a) (1) read as follows:

**"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 sales of that retailer 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. [Emphasis added.]

Thus, if the pre-1993 version of subdivision 1802 (b) (5) is to be interpreted consistently with the accepted interpretation of the other sales tax allocation rules of regulation 1802 its reference to the “place of sale” as being the location of the “stock of property” must also be interpreted as causing that location to be used for allocation purposes. For example, Subdivision 1802 (a) (1) referred to a single “place of business” as the location of all sales where only one such place existed in the state. These regulatory provisions implement RTC Section 7205 (a) which has always stated:

“For the purposes of a sales tax imposed by an ordinance adopted pursuant to this part, all retail sales are consummated at the place of business of the retailer unless the tangible personal property sold is delivered by the retailer or his agent to an out-of-state destination or to a common carrier for delivery to an out-of-state destination . . . .”  
[Emphasis supplied.]

Section 7205 articulates the basic premise of the Bradley-Burns sales tax which has always used a sales office orientation for allocating the local sales tax on retail sales. The exact wording describes “the place of business of the retailer” to control the allocation of sales tax revenue. This language ties in directly to RTC Section 6226 which describes “distribution . . . houses or offices” as “places of business” which must be registered by the taxpayer

Article II, paragraph B of the Agreement For State Administration of the Bradley-Burns Sales and Use tax (“Agreement”) (See Exhibit “A”) requires the Board to transmit “the amount to which the City is entitled,” e.g., the amount of revenue arising under the city’s ordinance because of sales activities within its jurisdiction. (Agreement p.1; See also, RTC Section 7204 on which this BOE obligation in the Agreement is based.)

Article III, paragraph B of the Agreement (Exhibit A) governs use of the pooling formula for making distribution of local sales or use tax revenue indirectly through the county or state pools. In the absence of permission provided in the Agreement to use pooling, the default rule governing all distributions under RTC Section 7204 is direct or “situs” allocation. This policy is supported by most local jurisdictions and businesses, as well as the League of California Cities and, the Board Members themselves in many recent decisions involving the use of pooling.

Generally speaking, Article III, paragraph B permits pooling only when the place of sale or use is not registered or it is otherwise “impractical” to do so. Therefore, in the context of consumption by a taxpayer’s distribution house or from its stock of tangible personal property, the pooling issue will be governed by whether the location in question can be registered.

The registration issue is controlled by RTC Sections 6226 and 6066, and more particularly by Subdivision 1699 (a) which filters out many types of distribution houses, particularly those that operate in conjunction with other California places of business to consummate sales principally negotiated at such. That type of distribution house activity is not involved in the approximately thirty controversies known to be pending.

Thus, prior to 1993, if subject to registration under Subdivision 1699 (a), the "place of sale" as defined in Regulation 1802, was regarded as designating the jurisdiction to which sales tax revenue was to be distributed by the Board in accordance with RTC Section 7204 and the Agreement. Therefore, in those circumstances, it was unnecessary to add the final sentence to present subdivision 1802 (b) (5) in order for it to require direct distribution by situs.

For example, no additional wording in the regulations had ever been deemed necessary to assign a single point of distribution under other subdivisions of Regulation 1802 before the amendment of Subdivision 1802 (b) (5) in 1993. And that wording was added only subsequent to the submission of a number of reallocation requests by MMC's predecessor, Municipal Resource Consultants, based on the pre-1993 language of that provision. The apparent purpose was to support the Staff's institutional preference for county pool distributions, even in the absence of any "plain language" requiring pooling.

Thus MMC contends that the new wording added to this subdivision in 1993 only clarified what its correct meaning had been all along under the Agreement, the statute and the regulations. Therefore the October 1, 1993 date must be regarded as ineffectual since the new language only affirmed and did not change the controlling provisions of Subdivisions 1802 (b) (5) and 1699 (a).

Once the stock of goods has been identified as the place where a sale has been completed and therefore to be reported by the taxpayer, the remaining key issue is whether a stock of tangible personal property being held for sale could be registered under Subdivision 1699 (a) prior to the 1993 amendment. If so, there would be no basis for requiring indirect distributions through county pools.

The justification for requiring registration of a stock of merchandise is originally contained in RTC Section 6226 which refers to "distribution . . . houses or offices or other places of business" as locations that "[e]very retailer selling tangible personal property for . . . use or consumption in this State shall register with the Board." Thus, under the "plain language" of the Revenue and Taxation Code, such locations have always clearly qualified as "places of business" that must be at least considered for registration under RTC Section 6066 and recognized for direct distribution purposes if registration is appropriate under the regulations. The relevant provisions of Subdivision 1699 (a) identify the small minority of distribution centers that must be registered.

In fact since at least 1980, that provision has always read:

“ . . . but at least one permit must be held by every person maintaining stocks of merchandise in this state for sale.”

Therefore, either before or after October 1, 1993 there was never a “plain language” impediment to allocating and distributing local sales tax by situs directly to the jurisdictions in which stocks of goods were located if the retailer had no other registered places of business in the state. Certainly, in most situations, retailers taking orders out of state will know where goods are being shipped from to make the necessary deliveries, and direct reporting and distribution will not be “impractical.” (See Agreement, Article III, paragraph B.)

This history demonstrates that the 1993 changes in Subdivision 1802 (b) (5) only confirmed what had been the law all along under the prior regulations and the controlling statutes as long as the taxpayer does not have another place of business in the state. Since at least 1980, the first sentence of the subdivision has always located the place of sale in the jurisdiction where the goods are located, and Regulation 1699 (a) has also provided for registration of stocks of goods that are the only place of business of the retailer in the state. Therefore the retrospective date of October 1, 1993 should be stricken from proposed Subdivision 1802 (c) (1).

Proposed Subdivision 1802 (c) (2) (See Subdivision 1802 (a) (2).)

Adding proposed Subdivision 1802 (c) (2) to the regulation as contained in the Initial Discussion Paper is both confusing and unnecessary because its general meaning is already reflected in Subdivision 1802 (a) (2) (A) that was recently debated and adopted by the Board Members as a clarifying amendment in 2002 and 2003. A major purpose of new Subdivision 1802 (a) (2) (A) was to reflect in Regulation 1802 the theory reflected in the ruling issued under Regulation 1802 by the Assistant Chief Counsel, Sales and Use Taxes, on January 19, 1993 to the City of Pittsburg. (See Exhibit B.) That ruling held that local sales tax on shipments to an in-state purchaser of manufactured rail cars from a factory located in Pittsburg to fulfill a contract of sale negotiated out of state was to be allocated to that jurisdiction directly and not indirectly through the county pool.

This 1993 ruling was described as having been issued under Subdivision 1802 generally, not under Subdivision 1802 (b) (5), because the express language of the latter prohibited the taxpayer from having other places of business in California. This ruling was featured in an *amicus* brief filed by the City of Union City in support of the petitioners in Appeal of Fremont and also in the rule-making file forwarded to OAL in 2003 in support of Subdivision 1802 (a) (2) (A). Therefore, clarified 1802 (a) (2) (A) should be interpreted as satisfying the requirements for consistent administration of the statute that were added by the Bradley-Burns Bill of Rights in 1998. (See RTC Sections 7223 and 7224.)

Accordingly, there is no need for the second proposal to be adopted at all because its essential meaning is already reflected in Subdivision 1802 (a) (2) (A). Were it to be approved by Board Members, it should not be adopted prospectively only because such an effective date implies that Regulation 1802 (a) (2) does not already apply to some thirty outstanding inquiries and pending appeals, some of which have already been briefed to Board Members. Furthermore, any alteration of local sales tax allocation rules prospectively appears to be prohibited by Proposition 1A, as adopted by the voters in November of 2004. (See [www.ss.ca.gov](http://www.ss.ca.gov), which includes both the language of the constitutional amendment and the ballot pamphlet material describing its intent.)

Another problem with Subdivision 1802 (c) (2) as proposed in the Second Discussion Paper dated June 10, 2005 is that it creates a strong possibility of unintended consequences. The Initial Discussion Paper and the Second Discussion Paper describe the principal problem being addressed as extending,

“ . . . direct distribution of local sales taxes to the city, county, or city and county where the retailer’s stock of tangible personal property is located [the warehouse] 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. . . . ” (See I. Issue, Initial Discussion Paper, page 1 of 9; Id. Second Discussion Paper, page 1 of 6.)

Notwithstanding this express intent, Subdivision 1802 (c) (2), as contained in the Second Discussion Paper, would appear to have the unintended consequence of denying direct distributions in certain cases. In this respect, it would cause a possible conflict with Subdivision 1802 (a) (2) (B) which states that the sale occurs “at the place of business where the principal negotiations are carried on” if more than one place of business in the state participates in a sale. The later version of the second proposed Staff Amendment requires there to be “no participation,” no matter how slight, by any other place of business of a taxpayer in sales negotiated out of state and fulfilled by a distribution house located in state for direct distribution to apply. It reads as follows:

“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 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.” (Language new in Second Discussion Paper italicized.)

In contrast, Subdivision 1802 (a) (2) (B) (and its predecessor Subdivision 1802 (a) (2)) has read for many years that:

“ 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.”

Thus the new phrase added to proposed Subdivision 1802 (c) (2) in the Second Discussion Paper could easily be interpreted to conflict with the “principal” participation test contained in existing Subdivision 1802 (a) (2) (B) by prohibiting any other place of business from being involved at all if direct distribution is to apply under it. This would sow doubt and confusion rather than provide certainty in any situation where there is another place of business in addition to the distribution house that has consummated a sale negotiated out of state. There is no reason to adopt a provision that would not provide clarity in the context of the issue addressed by both BOE Discussion Papers.

Thus, if a retailer accepted certain orders out of state, but others were taken in-state, distribution house shipments from a location in California to fulfill the out-of-state orders would not qualify

under the second Staff version of proposed Subdivision 1802 (c) (2) for direct allocation and distribution if the other place or places of business were involved to any extent in the orders taken out of state. Such involvement might take the form of an in-state credit check, drummers assisting in stimulating the out-of-state orders or principal negotiations, or even, arguably, manufacturing the product or otherwise providing inventory to the final location from which distribution is made.

The addition of this prohibition needs to be considered carefully to determine whether another approach to this issue, which is not strictly presented by the question raised in the Discussion papers, should be addressed separately in this proposal or in another Interested Party Proceeding, because of its possible wider implications.

#### The Potential Annual Revenue Impact of the Pending Appeals

The Initial Discussion Paper dated April 19, 2005 page 8 states that Staff does not have sufficient data to make an accurate estimate of the effect of changing its policy to require direct rather than county pool allocation of sales tax on shipments from in-state distribution offices or centers to consummate sales to California purchasers that are negotiated out of state. Nevertheless, its estimate is that the prospective change from county pool to direct distribution contained in the Staff's second proposal would potentially affect 12,278 accounts and shift \$ 244.1 MM out of the county pools, each year apparently.

Based on detailed studies of this issue over the past twelve years and some thirty accounts in which it has been identified during or prior to that period, MMC believes the estimate of \$ 244.1 MM to be a gross over-statement of the actual potential effect of the second proposal. A more reliable basis for making an accurate estimate is contained on page 9 of the Initial Discussion Paper where a value of approximately \$ 16.1 million was placed on inquiries involving this issue that are currently in one stage or another of the Regulation 1807 appeal process. Those appeals usually involve a number of reporting periods and different years; therefore, a reasonable estimate of the maximum effect of this change in Staff policy should lie somewhere in the range of shifting \$ 3 MM to 4 MM per annum from the pools to direct distribution.

Thus a more reliable aggregate estimate of the effect of the change in Staff policy, after adjusting for jurisdictions not represented by MMC, might lie in the range of \$ 6 MM to \$ 8 MM per annum. Assuming aggregate annual pool distributions ranging from \$ 550 MM to \$ 600 MM, slightly more than one percent of the aggregate annual pool distributions only should be affected. Therefore, it seems doubtful that the proposed policy change would be noticeable to very many jurisdictions.

During the second Interested Party Meeting, representatives of the Legal Department seemed to express another possible ground for placing a large revenue estimate on the effect of adopting the second proposed change by clarifying rather than changing current law and policy. They voiced concerns that expired dates of knowledge under RTC Section 7209 could somehow be revived if the second proposal were adopted without a prospective effective date. However, if old dates of knowledge have been allowed to expire by their proponents, it is clear that the failure to exhaust administrative remedies by pursuing an appeal through the Board Member level would prohibit either reviving such expired inquiries administratively or through litigation in court. See Regulation 1807 (c) (5) (C) and (d).

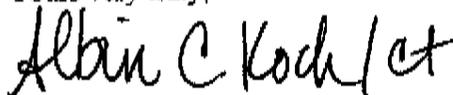
Alternative Recommendations

MMC is willing to accept proposed new Subdivision 1802 (c) (1) to replace existing Subdivision 1802 (b) (5) only with omission of the words "Operative October 1, 1993" from the second sentence.

The second proposal should be adopted only with the exclusion of the words "Operative July 1, 2006," at the beginning of the second sentence. Secondly, further consideration should be given to the language added in the second Discussion Draft to solve the problem raised in Mr. Bystrom's letter.

If additional explanation of the comments or alternative proposals contained in this response letter would be helpful, please contact me at your convenience. In addition, MMC stands ready to meet with Staff during the month of August to determine whether the problem addressed by Mr. Bystrom's letter of May 8 can be dealt with without creating a strong possibility of unintended and undesirable consequences.

Yours very truly,



Albin C. Koch  
General Tax Counsel  
MBIA MuniServices Co.

CC: Board Members  
Brian Hatch  
Randy Dryden  
Fran Mancia  
Janis Varney  
Doug Jensen  
Robert E. Cendejas  
Robert L. Buntjer  
Richard Goodrich  
Robert J. Wils  
Cecilia Watkins  
John Waid

**EXHIBIT**A

EXHIBIT 9

City of \_\_\_\_\_

**AGREEMENT FOR STATE ADMINISTRATION OF LOCAL SALES AND USE TAXES**

To carry out Part 1.5 of Division 2 of the Revenue and Taxation Code and the sales and use tax ordinance of the City hereinabove designated, hereinafter called the City, copy of which ordinance is attached hereto, the City and the State Board of Equalization, hereinafter called the Board, do agree as follows:

**ARTICLE I****DEFINITIONS**

Unless the context requires otherwise, wherever the following terms appear in this Agreement they shall be interpreted to mean the following:

1. "Local Taxes" shall mean the sales and use taxes, penalties, and interest imposed by the City under an ordinance which complies with Part 1.5, Division 2, of the Revenue and Taxation Code.

2. "Conforming Taxing Jurisdiction" shall mean any county, city, or city and county of this State which has adopted a sales and use tax ordinance of the kind described in Part 1.5 of Division 2 of the Revenue and Taxation Code and which has entered into a contract with the State Board of Equalization to perform all functions incident to the administration and operation of the ordinance.

3. "City Ordinance" shall mean the Uniform City Sales and Use Tax Ordinance attached hereto, as amended from time to time.

**ARTICLE II****ADMINISTRATION AND COLLECTION OF LOCAL TAXES**

A. Administration. The Board and the City agree that the Board shall perform exclusively all functions incident to the administration and operation of the City ordinance.

B. Other applicable laws. The City agrees that all provisions of law applicable to the administration and operation of the State Sales and Use Tax Law shall be applicable to the administration and operation of the City ordinance and that money collected pursuant to the City ordinance may be deposited in the State Treasury to the credit of the Retail Sales Tax Fund and may be drawn from that Fund for the purpose of making refunds, for the purpose of compensating and reimbursing the Board pursuant to Article IV of this Agreement and for the purpose of transmitting to the City the amount to which the City is entitled.

C. Transmittal of money. Except as otherwise provided herein, all local taxes collected under the provisions of the City ordinance shall be transmitted to the City periodically as promptly as feasible. Such transmittals shall be made at least twice in each calendar quarter. Transmittals may be made by mail or by deposit to the account of the City in a bank in Sacramento designated by the City. A statement shall be furnished indicating the amount withheld pursuant to Article IV of this agreement.

D. Rules. The Board shall prescribe and adopt such rules and regulations as in its judgment are necessary or desirable for the administration and operation of the City ordinance and the distribution of the local taxes collected thereunder.

E. Preference. Unless the payor instructs otherwise and except as otherwise provided in this Agreement, the Board shall give no preference in applying money received for sales and use taxes owed by a taxpayer but shall apply all monies collected to the satisfaction of the claims of the State and the claims of the City as their interests appear.

F. Security. The Board agrees that any security which it hereafter requires to be furnished under the State Sales and Use Tax Law will be upon such terms that it also will be available for the payment of the claims of the City for local taxes owing to it as its interest appears. The Board shall not be required to change the terms of any security now held by it and the City shall not participate in any security now held by the Board.

G. Names of sellers. The Board agrees to furnish the names, addresses, account numbers, and the business classification codes of all sellers holding sellers' permits within the City.

H. Records of the Board. When requested by resolution of the City Council of the City, the Board shall permit any duly authorized officer or employee of the City to examine the sales and use tax records of the Board pertaining to sales and use taxes collected for the City by the Board pursuant to this Agreement. Information obtained by the City from the examination of the Board's records shall be used by the City only for purposes related to the collection of local sales and use taxes by the Board pursuant to this Agreement.

I. City tax rate. The City agrees that any change in the rate of its conforming local sales and use tax will be made effective at the beginning of a calendar quarter and that it will give the Board at least two months' notice thereof and that it will also give notice to the Board of Supervisors of the County in which the City lies.

J. Annexation. The City agrees that the Board shall not be required to give effect to an annexation, for the purpose of collecting and distributing city sales and use taxes, earlier than the first day of the calendar quarter which commences not less than two months after notice to the Board. The notice shall include two maps of the annexed area together with the address of the property nearest to the extended city boundary on every street crossing that boundary.

### ARTICLE III

#### ALLOCATION OF TAX

A. Deficiency determination. All local taxes collected as a result of determinations or billings made by the Board, and all amounts refunded or credited may be distributed or charged to the respective conforming taxing jurisdictions in the same ratio as the taxpayer's self-declared local tax for the period for which the determination, billing, refund, or credit applies.

B. Allocation. When the local tax is collected from or refunded or credited to the following:

- (1) Retailers having traveling sellers' permits or certificates of authority to collect use tax issued by the Board;
- (2) Persons regarded by the Board as retailers pursuant to Section 6015 of the Revenue and Taxation Code;
- (3) Persons for whom no continuing account number was active at the date of payment; or
- (4) Other retailers or purchasers having no permanent place of business within the State as determined by the Board;

EXHIBIT 9

or when the local tax is collected by way of deduction from, or when a refund of local tax is made in conjunction with, refunds of motor vehicle fuel license taxes, or when local tax is collected and direct allocation is impractical, the Board may distribute or charge such local tax to all conforming taxing jurisdictions in the county in which the sale or use occurred using the ratios reflected by the distribution of taxes collected from all other taxpayers in that county. To the extent that this cannot be done in a manner consistent with the economic and efficient performance of the duties of the Board under the Revenue and Taxation Code and the provisions of this Agreement, the Board may distribute or charge such local tax to all conforming taxing jurisdictions of this State using the ratios reflected by the distribution of taxes collected from all other taxpayers in the State. In making allocations under this paragraph county tax imposed at a rate in excess of 1 percent shall be excluded.

C. **Vehicles, Vessels, and Aircraft.** For the purposes of allocating local tax with respect to vehicles required to be registered or identified under the Vehicle Code, and with respect to vessels and aircraft, the address of the registered owner appearing upon the application for registration or identification may be used by the Board in determining the city of use. To the extent this cannot be done in a manner consistent with the economic and efficient performance of the duties of the Board under the Revenue and Taxation Code and this Agreement, the Board may allocate tax with respect to such vehicles, vessels, and aircraft in the manner provided in Paragraph B of this Article.

#### ARTICLE IV

#### COMPENSATION

The City agrees to pay the Board as the Board's cost of administering the City ordinances such amount as is provided by law. Such amounts shall be deducted from the taxes collected by the Board for the City.

#### ARTICLE V

#### MISCELLANEOUS PROVISIONS

A. **Communications.** Communications and notices may be sent by first-class United States Mail. A notification is complete when deposited in the mail. Communications and notices to be sent to the Board shall be addressed to:

State Board of Equalization  
P.O. Box 1799  
Sacramento, California 95808

Attention: Executive Secretary

Communications and notices to be sent to the City shall be addressed to:

EXHIBIT 9

B. Term. The date of this Agreement is the date on which it is approved by the Department of General Services. The Agreement shall take effect on the first day of the calendar quarter next succeeding the date of such approval, but in no case before the operative date of the City ordinance, nor on a day other than the first day of a calendar quarter. This Agreement shall continue until September 30 next following the operative date of the City ordinance, and shall thereafter be renewed automatically from year to year unless one of the parties gives written notice of termination at least two months before the end of the term. The Board may terminate this Agreement in the manner provided by law.

23

C. This Agreement replaces and supersedes the Agreement dated March 31, 1956 heretofore entered into by the Board and the City, which prior Agreement is hereby terminated.

STATE BOARD OF EQUALIZATION

By W. W. Dwyer  
Executive Secretary

CITY OF \_\_\_\_\_

By \_\_\_\_\_  
(Signature on this line)

\_\_\_\_\_  
(Type name here)

Mayor  
(Type title here)

\_\_\_\_\_  
CLERK OF THE COUNCIL

APPROVED AS TO FORM [Signature]

STORY POLICY [initials]  
Department of General Services  
APPROVED  
DEC 14 1973  
[Signature]  
Assistant to the Director

**EXHIBIT** B

EXHIBIT 9



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**1020 N STREET, SACRAMENTO, CALIFORNIA  
P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001  
(916) 446-3723MEMBER  
First DistrictBRAD SHEPHERD  
Second District, Los AngelesERNEST J. BRONENBURG, JR.  
Third District, San DiegoMATTHEW K. FONG  
Fourth District, Los AngelesGRAY DAVIS  
Controller, SacramentoBURTON W. OLIVER  
Executive Director

REC'D JAN 22 1993

January 19, 1993

Mr. John T. Austin  
Municipal Resources Consultants  
32107 W. Lindero Canyon Road, Suite 323  
Westlake Village, CA 91361

Re:

Dear Mr. Austin:

We have been asked to comment further upon your inquiry of August 14, 1992, addressed to Mr. Lawrence D. Micheli, in regard to application of local sales tax to sales of rail cars by Corporation to the Bay Area Rapid Transit District. Mr. John Waid of our office wrote to you on this subject by letter dated September 16, 1992.

It is our opinion that the local tax in question which is applicable to these sale transactions is the local tax imposed by the City of Pittsburg. Our Regulation 1802 identifies the place of sale for Bradley-Burns Uniform Local Sales and Use Tax purposes. Insofar as the transactions in question are concerned, it appears that the seller has multiple places of business in this state. Yet, it further appears that the California locations of the seller did not participate at all in negotiating the sales contract.

The property sold is manufactured at, and delivered to, the purchaser from the Pittsburg location. We issued a seller's permit to the seller because of the activities occurring at the Pittsburg location. Revenue and Taxation Code section 6006 requires that each person desiring to engage in or conduct

EXHIBIT 9

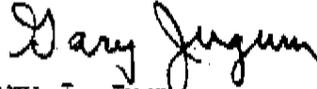
Mr. John T. Austin

- 2 -

January 19, 1993

business as a seller within this state shall file with the Board an application for a permit for each "place of business". Under the circumstances of this case, it is our opinion that the place of sale for local tax purposes is the place of business of the retailer located in the City of Pittsburg.

Very truly yours,



Gary J. Jugum  
Assistant Chief Counsel

GJJ:sr

cc: Honorable Matthew K. Fong



City of Compton

**OFFICE OF THE CITY MANAGER**

BARBARA KILROY  
City Manager

(310) 605-5585  
Fax (310) 761-1429

June 27, 2005

Ms. Cecilia Watkins  
State Board of Equalization  
450 N Street  
Sacramento, CA 95814

*Subject. Proposed Amendments to Board of Equalization Regulation 1802*

Dear Ms. Watkins:

The City of Compton is responding to the Board's request for public comment on its Second Issue Paper on proposed amendments to Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Local Sales and Use Taxes*.

The City opposes Board Staff efforts to amend Regulation 1802 in fairness to more than thirty outstanding appeals or inquiries involving this issue in order to preserve taxpayer confidentiality. We believe there is "plain language" support in existing Regulation 1699, *Permits*, for requiring registration of these distribution centers and therefore distribution of the subject revenues by situs to the single jurisdiction where the centers are located without changing the current regulations.

The City does not believe that there is any need, or that it would be fair to jurisdictions that have complied with the dispute resolution process embodied in Regulation 1807 (effective January 1, 2003), to revisit this issue in the regulatory process until the pending "lead" appeal dispute has been considered. Also the prospective effective date of July 1, 2006 is not necessary since the language being proposed would only "clarify" what the appealing cities and counties in the pending disputes believe to be the law now, under Regulation 1699 as well as Regulation 1802.

We therefore request that the Board approve clarification language to existing law instead of imposing a 'new' regulation.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Barbara Kilroy".

BARBARA KILROY  
CITY MANAGER

cc: Jean Korinke, League of California Cities (by facsimile to 916-658-8240)  
Honorable John Chiang (by facsimile to 916-323-2869)

bcc: Doug Jensen, MBIA MuniServices Company (by facsimile to 559-312-2938)  
Fran Mancia, MBIA MuniServices Company (by facsimile to 559-312-2938)



COMPTON CITY HALL

205 South Willowbrook Avenue Compton, California 90220

## 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.

To enable local sales tax to be allocated directly to a jurisdiction, the business location must qualify for, and be issued, a seller's permit.<sup>1</sup> 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

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<sup>1</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 a retailer who had no in-state selling location, no subpermits were issued to in state stocks of goods until 1993. Local sales tax was allocated to the jurisdiction of the warehouse using the county-wide pools. For ease of reference, in this discussion we refer generally to the permit issued to a selling location as a "seller's permit."

## Local Tax History

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.<sup>2</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> 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.

### General Statistics for Local Tax Reallocation Inquiries

As indicated in the issue paper, while for the purpose of this topic staff identified 24 local tax appeals cases that specifically involve the reallocation of the local sales tax from the county wide pools to the location of the warehouse, questions have arisen regarding the number of total inquiries filed by the Inquiring Jurisdictions and their Consultants with the Board for all issues. The table below shows these statistics.

Period	Allocation Group (AG)		Local Tax Appeals Auditor (LTAA)		Appealed to Board Management (BM)	Appealed to the Board
	Inquiries Received	Inquiries Completed	Appealed	Conferences Held		
Beginning inventory	5,215	0	200	0	0	0
7/1/99 – 6/30/00	4,622	5,363	22	31	21	0
7/1/00 – 6/30/01	6,352	7,428	43	171	167	1
7/1/01 – 6/30/02	13,661	7,162	19	18	6	2
7/1/02 – 6/30/03	11,283	14,906	5	6	5	6
7/1/03 – 6/30/04	13,093	14,102	27	14	5	4
7/1/04 – 5/31/05	8,706	8,741	13	4	2	0
<b>Total</b>	<b>62,932</b>	<b>57,702</b>	<b>329</b>	<b>244<sup>1</sup></b>	<b>209</b>	<b>13</b>
Ending inventory as of 5/31/05	5,260		55		3	9 <sup>2</sup>
Closed cases	57,702		274		206	4 <sup>3</sup>
Percentage			0.52%		63.56%	6.22%
			<b>A</b>		<b>B</b>	<b>C</b>
<b>A.</b> Less than 1% ( $329/62,932 = .52\%$ ) of inquiries filed with the AG are appealed to the LTAA.						
<b>B.</b> About 64% ( $209 / 329 = 63.56\%$ ) of inquiries appealed to the LTAA are appealed to BM.						
<b>C.</b> About 6% ( $13 / 209 = 6.22\%$ ) of inquiries appealed to BM are appealed to the Board. 12 of these cases have been appealed to the Board since FYE 6/30/2002.						

<sup>1</sup> One (1) of these cases involves a mass appeal that includes over 1000 cases. The issue in these cases is sales versus use tax. The mass appeal is included in the nine (9) cases appealed to the Board.

<sup>2</sup> Four (4) of these cases involve the warehouse rule and five (5) are pending Board Hearing.

<sup>3</sup> These four (4) cases have previously been heard and decided.