

Memorandum

To: Honorable Jerome E. Horton, Chairman
Senator George Runner, Vice Chair
Honorable Fiona Ma, CPA, Second District
Honorable Diane L. Harkey, Fourth District
Honorable Betty T. Yee, State Controller

Date: January 6, 2016

From: 
Randy Ferris
Chief Counsel

Subject: Board Meeting, January 26, 2016
Chief Counsel Matters – Item J. Rulemaking
Petition to Amend Sales and Use Tax Regulation 1569,
Consignees and Lienors of Tangible Personal Property for Sale

On Tuesday, November 17, 2015, the Legal Department received a petition dated November 12, 2015, from Mr. Tony DeMarco on behalf of the California Pawnbrokers Association (Petitioner), pursuant to Government Code section 11340.6. On Monday, November 23, 2015, the Legal Department received a revised petition from Petitioner dated November 17, 2015, which superseded the original, requesting an amendment to California Code of Regulations, title 18, section (Regulation or Reg.) 1569, *Consignees and Lienors of Tangible Personal Property for Sale*. The petition seeks to add subparagraph (1) pertaining to “the taxability of the transfer of personal property between a pawnbroker and the original pledg[o]r.” Specifically, the petition would “add clarifying language . . . to allow the original pledg[o]r to redeem personal property from a pawnbroker within six months of the expiration of the grace period as a non-taxable event.”

This matter is scheduled for the Board’s consideration at the January 26, 2016, Board meeting on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process to repeal or amend the regulation by ordering publication of a notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested repeal or amendments in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition in its entirety because, as explained below, tax applies to the retail sale of tangible personal property in California, unless specifically exempt from taxation by statute, and the petition would, in effect, add an exemption for which there is no statutory basis.

This memorandum sets forth: (1) relevant background information pertaining to the Sales and Use Tax Law and to the provisions of the Financial Code relating to pawnbrokers; (2) a discussion of and staff's response to the petition; and (3) staff's recommendation.

I. Background Information

A. *Sales and Use Tax Law*

Revenue and Taxation Code (RTC) section 7051 provides that the "board shall enforce the provisions of [the Sales and Use Tax Law] and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part." A regulation adopted by a state agency, to be effective, must be within the scope of authority conferred. (Gov. Code, § 11342.1.) Whenever a state agency is authorized by statute to "adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of the statute, no regulation adopted is valid or effective unless consistent and not in conflict with the statute . . ." (Gov. Code, § 11342.2; see *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 16 (conc. opn. of Mosk, J.).)

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in California unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, §§ 6051, 6091.) The retailer is directly liable for the sales tax but may collect sales tax reimbursement from the customer if the contract of sale so provides. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) When sales tax does not apply, use tax is imposed, measured by the sales price of tangible personal property purchased from a retailer for storage, use, or other consumption in California, unless specifically exempted or excluded from taxation by statute. (Rev. & Tax. Code, §§ 6201, 6401.) The consumer is directly liable for the use tax. (Rev. & Tax. Code, § 6202.)

A sale means and includes any transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code, § 6006, subd. (a).) "Transfer of possession" includes only transactions found by the board to be in lieu of a transfer of title, exchange, or barter. (*Ibid.*) A retail sale means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property. (Rev. & Tax. Code, § 6007.)

A retailer includes every seller who makes any retail sale or sales of tangible personal property and every person engaged in the business of making sales for storage, use, or other consumption. (Rev. & Tax. Code, § 6015.) A retailer also includes every individual, firm, copartnership, joint venture, trust, business trust, syndicate, association or corporation making more than two retail sales of tangible personal property during any 12-month period. (Rev. & Tax. Code, § 6019; see *Davis Wire Corp. v. State Bd. of Equalization* (1976) 17 Cal.3d 761, 767 [stating that section 6019 does not constrict, but enlarges, the statutory definition of retailer].) A seller is a person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax. (Rev. & Tax. Code, § 6014.)

There is no statutory authority in the Sales and Use Tax Law that specifically deals with pawnbrokers. Regulation 1569 states that “[p]awnbrokers, storage men, mechanics, artisans, or others selling the property to enforce a lien thereon, are retailers with respect to sales of the property to consumers and tax applies to the receipts from such sales.” The only referenced authority for Regulation 1569 is RTC section 6015, which, as stated above, sets forth the general definition of a retailer.

B. Financial Code Provisions Related to Pawnbrokers

Loans made by pawnbrokers are subject to Division 8 of the California Financial Code. (Fin. Code, § 21000 et seq.) A pawnbroker is defined as any person engaged in the business of receiving goods in pledge as security for a loan. (Fin. Code, § 21000.) Pledged property is property held as security for a loan, the title to which remains with the pledgor and has not passed to the pawnbroker pursuant to Financial Code section 21201. (Fin. Code., § 21002.) Vested property is property the title to which has been transferred from the pledgor to the pawnbroker pursuant to Financial Code section 21201. (*Ibid.*)

Chapter 2 of Division 8 sets forth the provisions that control the terms and conditions of loans made by pawnbrokers. (Fin. Code, § 21200 et seq.) Financial Code section 21201 sets forth the procedures by which a pawnbroker may foreclose on pledged property. Specifically, within one month after the expiration of the loan period, the pawnbroker must send a notice to the borrower, and if the pledged article is not redeemed within 10 days of the notice, “the pawnbroker shall become vested with all right, title, and interest of the pledgor, or his or her assigns, to the pledged article, to hold and dispose of as his or her own property.” (Fin. Code, § 21201, subd. (f).) Once the 10-day grace period starts, pursuant to recent statutory changes that became effective January 1, 2016 (via Senate Bill (SB) 300), title will irrevocably vest with the pawnbroker unless the pledgor requests, and the pawnbroker consents to, a replacement loan prior to the expiration of the grace period. (Fin. Code, § 21201.5, subd. (b).)

II. Discussion of the Petition

The petition seeks to “add clarifying language . . . to allow the original pledg[o]r to redeem personal property from a pawnbroker within six months of the expiration of the grace period as a non-taxable event.” The proposed amendments would include a definition of “original pledgor” as “the person who transfers possession of pledged property to a pawnbroker as security for a pawn loan entered into with the Pawnbroker.” It would further state that the reacquisition of vested property by the original pledgor is a non-taxable transfer when it is in exchange for the final loan balance plus applicable interest and charges. The transaction would be taxable if the original pledgor pays more than the final loan balance plus applicable interest and charges and/or title vested in the pawnbroker more than six months prior.¹ The petition states that, currently, the “acquisition of vested personal property by the original pledg[o]r results in a duplicate payment of tax on a single item of personal property” and that a change would “further the public policy purpose of keeping ownership of the item with the consumer.”

As discussed above, Regulation 1569, which states that pawnbrokers are retailers with respect to sales of property to consumers and that tax applies to the gross receipts from such sales, is not based on statutory authority specific to pawnbrokers. Rather, it is based on the basic

¹ The petition is unclear as to whether an exchange for less than the final loan balance plus applicable interest and charges would constitute a taxable transaction.

definitions and general provisions of the Sales and Use Tax Law, and is consistent with the Financial Code. The ordinary business of a pawnbroker includes the sale of tangible personal property. (See, e.g., Fin. Code, § 21208 [compliance with reporting requirements of secondhand dealers]; see also Bus. & Prof. Code, § 21626, subd. (a) [defining secondhand dealer as including any person whose business includes buying, selling and taking into pawn secondhand tangible personal property].) Accordingly, when a pawnbroker transfers title of tangible personal property for any purpose other than resale in exchange for consideration, the transaction constitutes a retail sale. (Rev. & Tax. Code, §§ 6006, subd. (a), 6007.)

Pawnbrokers are thus considered retailers under the Sales and Use Tax Law in that they are sellers that make retail sales, they are persons in the business of making sales for storage, use or other consumption, and they are persons that make more than two retail sales during any 12-month period. (Rev. & Tax. Code, §§ 6014, 6015, 6019.) Therefore, tax applies to sales by pawnbrokers, unless the subject sale is specifically exempt by statute. (Rev. & Tax. Code, §§ 6051, 6091.)

There is no statutory basis to distinguish a retail sale made by a pawnbroker to a former pledgor of the tangible personal property from a sale to any other purchaser. As explained above, 10 days after notice is sent to the pledgor regarding the expiration of the loan period, the pawnbroker is “vested with all right, title, and interest of the pledgor, or his or her assigns, to the pledged article, to hold and dispose of as his or her own property.” (Fin. Code, § 21201, subd. (f) [emphasis added].) In other words, after title has vested with the pawnbroker, the former pledgor no longer has any legal right to the property that would distinguish him or her from any other third-party purchaser. Accordingly, at that time, if the pawnbroker were to transfer title to the former pledgor in exchange for consideration for any purpose other than resale, that transaction would constitute a retail sale under the Sales and Use Tax Law.² Since it is not specifically exempt by statute, the transaction is subject to tax. (Rev. & Tax. Code, §§ 6051, 6091.)

Therefore, the petition, in proposing to classify these retail sales as “nontaxable transfers,” is, in essence, proposing to create an exemption from the sales and use tax that is not based in statute. Notwithstanding any policy interest that may exist in seeing pledged property returned to the former pledgor, enactment of such a regulatory exemption would not be consistent with the Sales and Use Tax Law and thus not be within the scope of the regulatory authority conferred on the Board. (Rev. Tax Code, § 7051; Gov. Code, §§ 11342.1, 11342.2.)

III. Recommendation

Board staff recommends that the petition be denied because it seeks to create an exemption from the sales and use tax that is not based in statute and thus not within the scope of the Board’s regulatory authority.

² According to the relevant Senate Floor bill analysis, the California Pawnbrokers Association (i.e., Petitioner in this matter) was the source of SB 300 and supported the final language enacted. (http://www.leginfo.ca.gov/pub/15-16/bill/sen/sb_0251-0300/sb_300_cfa_20150908_214752_sen_floor.html.) This bill analysis also states: “This bill’s sponsor asserts that this clarification does not deprive borrowers of their ability to regain their pawned items; it merely requires them to purchase the items from the pawnbroker.” (*Ibid.*) In other words, once title has vested in the pawnbroker, the legislative history is clear that the Legislature intended that any subsequent transaction between the former pledgor and the pawnbroker be treated as a retail transaction.

If you need more information or have any questions, please contact Assistant Chief Counsel Robert Tucker at (916) 322-0437.

Approved:


Cynthia Bridges
Executive Director

Attachments: Petitioner's revised petition dated November 17, 2015, and attachments.
 Petitioner's petition dated November 12, 2015, and attachments

RF:bk

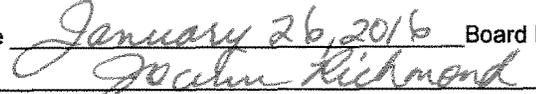
cc: Ms. Cynthia Bridges MIC:73
 Mr. David Gau MIC:101
 Mr. Robert Tucker MIC:82
 Mr. Scott Claremon MIC:82

STATE BOARD OF EQUALIZATION

REFERRED TO LEGISLATIVE COMMITTEE



At the January 26, 2016 Board Meeting


Joann Richmond, Chief
Board Proceedings Division



California Pawnbrokers Association

November 17, 2015

State Board of Equalization
Attn: Mr. David Gau, Deputy Director
450 N Street MIC: 101
Sacramento CA 95814

Revision Placement
of Language

**RE: Petition to Amend Language to California Code of Regulations Title 18 Section 1569
Consignees and Lienholders of Tangible Personal Property For Sale**

Dear Mr. Gau,

Pursuant to Government Code Section 11340.6 and the State Board of Equalization's (BOE) authority under Revenue and Taxation Code Section 7051, the California Pawnbroker's Association hereby petitions the State Board of Equalization to amend California Code of Regulations Section 1569 pertaining to the taxability of the transfer of personal property between a pawnbroker and the original pledger.

Current regulations have interpreted the acquisition of vested personal property by the original pledger subsequent to the expiration of the grace period as defined in Financial Code Section 21201 as a taxable transaction. This situation results in a duplicate payment of tax on a single item of personal property, once upon the original acquisition of the item and again upon redemption. This change would also further the public policy purpose of keeping ownership of the item with the consumer.

To remedy this situation, the California Pawnbroker's Association petitions the BOE to add clarifying language (attachment) to allow the original pledger to redeem personal property from a pawnbroker within six months of the expiration of the grace period as a non-taxable event.

Thank you for your consideration of our petition.

Sincerely yours,

A handwritten signature in blue ink that reads "Tony DeMarco".

Tony DeMarco
President CAPA
Attachment



CLINE & DUPLISSEA

BILL DUPLISSEA

1127 - 11TH STREET, SUITE 544
SACRAMENTO, CALIF 95814
PH (916) 441-4844
FX (916) 441-0221
BILL@CLINE-DUPLISSEA.COM
WWW.CLINE-DUPLISSEA.COM

California Pawnbrokers Association
One Capitol Mall, Suite 800
Sacramento, CA 95814
916-669-5322 | californiapawnbrokers.org

ARTICLE 6. SPECIFIC BUSINESSES ENGAGED IN RETAILING
REGULATION 1569

AMENDED REGULATION 1569, CONSIGNEES AND LIENORS OF TANGIBLE PERSONAL PROPERTY FOR SALE.

Reference: Section 6015, Revenue and Taxation Code and California Financial Code, Division 8, Pawnbrokers

Sales by court-appointed officers, see Regulation 1573.

A person who has possession of property owned by another, and also the power to cause title to that property to be transferred to a third person without any further action on the part of its owner, and who exercises such power, is a retailer when the party to whom title is transferred is a consumer. Tax applies to his gross receipts from such a sale.

Pawnbrokers, storage men, mechanics, artisans, or others selling the property to enforce a lien thereon, are retailers with respect to sales of the property to consumers and tax applies to the receipts from such sales.

(1) Pawnbrokers

(a) Definitions

(1) A "pawnbroker" includes any person engaged in the business of receiving goods, including motor vehicles, in pledge as security for a loan as described in Division 8 of the California Financial Code.

(2) "Original pledgor" means the person who transfers possession of pledged property to a pawnbroker as security for a pawn loan entered into with the Pawnbroker.

(3) "Pledged property" means property formally pledged as security for a pawn loan consistent with the provisions of Division 8 of the Financial Code.

(4) "Vested property" means the pledged property the title to which has transferred to a pawnbroker after the grace period set forth in Financial Code section 21201 has expired.

(b) APPLICATION OF TAX TO SPECIFIC TYPES OF TRANSACTIONS.

(1) RETURN OF VESTED PROPERTY TO THE ORIGINAL PLEDGOR.

When a pawnbroker returns vested property to the original pledgor, after the grace period set forth in Financial Code section 21201 has expired, a nontaxable transfer of the vested property from the pawnbroker to the original pledgor has occurred when the exchange is for;

- a. The loan balance as of the last day of the grace period,
- b. together with interest and charges (as provided by Division 8 of the Financial Code) accrued as of the date the property is returned to the pledgor up to 6 months from the transfer of title.

A sale of tangible personal property to the original pledgor is deemed to have taken place if either of the following has occurred.

- a. The original pledgor is required to pay amounts in excess of the loan balance as of the last day of the grace period, together with interest and charges (as provided by Division 8 of the Financial Code) accrued as of the date the property is returned to the pledgor.
- b. Title in the property has been vested in the pawnbroker for more than 6 months past the expiration of the grace period.

(2) RESALE OF VESTED PROPERTY TO A THIRD PARTY. Pawnbrokers who resell vested property to third parties, are retailers with respect to sales of the property to consumers and tax applies to the receipts from such sales.



California Pawnbrokers Association

November 12, 2015

State Board of Equalization
Attn: Mr. David Gau Deputy Director
450 N Street MIC: 73
Sacramento CA 95814

**RE: Petition to Amend Language to California Code of Regulations Title 18 Section 1569
Consignees and Lienholders of Tangible Personal Property For Sale**

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Current regulations have interpreted the acquisition of vested personal property by the original pledger subsequent to the expiration of the grace period as defined in Financial Code Section 21201 as a taxable transaction. This situation results in a duplicate payment of tax on a single item of personal property, once upon the original acquisition of the item and again upon redemption. This change would also further the public policy purpose of keeping ownership of the item with the consumer.

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Thank you for your consideration of our petition.

Sincerely yours,

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Tony DeMarco
President CAPA
Attachment

Chief Deputy Director
Executive Office

NOV 12 2015

RECEIVED
STATE BOARD OF EQUALIZATION

California Pawnbrokers Association
One Capitol Mall, Suite 800
Sacramento, CA 95814
916-669-5322 | californiapawnbrokers.org



Background & Need for the Regulation Change

Existing Law:

Under existing law, Article 1 of Chapter 2 of Part 1 of Division 2 of the Revenue and Taxation Code (Rev & Tax C, §§6051-6055) imposes a duty to collect sales tax on every California retail establishment for the privilege of making retail sales of tangible personal property in this state. Tangible personal property as defined by Rev & Tax C. 6016 is coextensive with "goods" as defined in Fin. C. §21000. A "sale" for purposes of this request is stipulated to mean "any transfer of title or possession . . . of tangible personal property for consideration," as set forth in Rev & Tax C. §6006.

Consequently, it is acknowledged that if a pawnbroker were to sell the vested property to a third party consumer, i.e., not the original pledger, the requirements of Article 1 would mandate the collection of sales tax.

Factual Basis for Regulatory Change:

CAPA would like to request a regulatory change codifying that the following transaction is a non-taxable event: A "sale back," defined as a circumstance where a pawnbroker sells back to the original pledger the same property that the borrower had pledged as security for a loan but where title to that property had vested with the pawnbroker following default if the item is still available.

Compelling Public Policy Supporting this Request:

CAPA's request for a regulatory change would further, two separate but interrelated public policies: the policy avoiding the unintentional loss of property and the policy to avoid double taxation.

For various legitimate reasons, pledgers sometime are unable to pay off the balance of the loan extended to them by a pawnbroker, or have sufficient economic resources at their disposal to pay even the charges due at the end of a typical four month pawn loan to obtain a replacement loan. Other borrowers may have moved, or equally unbeknownst to the pawnbroker, have incurred a debilitating injury, illness or other circumstance that precludes them from returning to or otherwise contacting the pawnbroker who has issued the loan. For these or similar reasons, after the ten-day notice has issued and the borrower fails to redeem the collateral or negotiate a replacement loan, the pawnbroker vests with title to the collateral by operation of law. There is no option on the part of the pawnbroker to delay, negate or refuse this title transfer.

When this individual recovers from their disability or returns to the area, sometimes the item they had pledged as security for the loan is available for sale. The item can be unequivocally established to be the same collateral as that pledged for the loan through the loan or inventory control system of the pawnbroker. More often than not,

the customer will have just sufficient cash to pay off the loan charges that were due at the end of the redemption period resulting in the foreclosure. The pawnbroker generally is more than willing to accommodate the customer and typically willing to sell back the collateral, title to which is now vested in the pawnbroker.

Unlike a transaction involving a third-party who might be interested in purchasing the property for its fair market value, the original pledger is typically cash strapped. They are interested in and can usually only afford to reacquire their property for the equivalent of the sum of the pawnbroker's lost interest and charges through the date of its reacquisition. Indeed, pawnbrokers generally are more than willing to transfer title back to the original pledger at this substantially discounted price in order to avoid a property forfeiture to their customers.

However, even at this deep discount, the typical pawn customer balks. The reasons may vary, but generally fall into two categories, one perhaps more emotional and one very pragmatic. They decline to consummate the transaction because, they argue, they have paid sales tax on the collateral when they acquired it originally, and would be paying tax twice on the same property.

Second, and frankly the pragmatic reason: They have very limited financial resources and cannot afford this additional amount, even if the sales tax is calculated on a price substantially below the fair market value of the property. Either reason results in a failed transaction.

Fundamentally, a failed transaction, results in a bad outcome for both the customer - who has forfeited their property- and for the pawnbroker who has potentially lost a customer forever. No one, not even the tax payers of California win in this situation. The most likely potential buyer has just walked away.

CAPA's Regulatory Request Recommended Limitations:

CAPA would respectfully recommend that any regulatory change creating a non-taxable event in the aforementioned circumstance be limited to instances where the following facts can be established for a period of six months from the date of the title transfer to the pawnbroker from the original pledgor: (1) The transaction occurs at the time the pawnbroker holds a license pursuant to Financial Code section 21300, et seq., both at the time of the issuance of the pawn loan and at the time of the resale; (2) the purchaser is the same listed on the original written pawn contract required by Financial Code section 21201; (3) The property sold is the same as the collateral originally taken as security for the loan issued to the customer now seeking to reacquire that property; (4) A written receipt or other document establishes the link both between the identity of the buyer and the original pledger and between the property being sold and the collateral lost through default by the pledger.

Sales And Use Tax Regulations

ARTICLE 6. SPECIFIC BUSINESSES ENGAGED IN RETAILING

REGULATION 1569

REGULATION 1569. CONSIGNEES AND LIENORS OF TANGIBLE PERSONAL PROPERTY FOR SALE.

Reference: Section 6015, Revenue and Taxation Code.

Sales by court-appointed officers, see Regulation 1573.

A person who has possession of property owned by another, and also the power to cause title to that property to be transferred to a third person without any further action on the part of its owner, and who exercises such power, is a retailer when the party to whom title is transferred is a consumer. Tax applies to his gross receipts from such a sale.

Pawnbrokers, storage men, mechanics, artisans, or others selling the property to enforce a lien thereon, are retailers with respect to sales of the property to consumers and tax applies to the receipts from such sales.

PROPOSED REGULATION 1569.5 PAWNBROKERS

Reference: Section 6015, Revenue and Taxation Code and California Financial Code, Division 8, Pawnbrokers.

(a) Definitions

(1) A "pawnbroker" includes any person engaged in the business of receiving goods, including motor vehicles, in pledge as security for a loan as described in Division 8 of the California Financial Code.

(2) "Original pledgor" means the person who transfers possession of pledged property to a pawnbroker as security for a pawn loan entered into with the Pawnbroker.

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(4) "Vested property" means the pledged property the title to which has transferred to a pawnbroker after the grace period set forth in Financial Code section 21201 has expired.

(b) APPLICATION OF TAX TO SPECIFIC TYPES OF TRANSACTIONS.

(1) RETURN OF VESTED PROPERTY TO THE ORIGINAL PLEDGOR.

When a pawnbroker returns vested property to the original pledgor, after the grace period set forth in Financial Code section 21201 has expired, a nontaxable transfer of the vested property from the pawnbroker to the original pledgor has occurred when the exchange is for;

- (1) The loan balance as of the last day of the grace period,
- (2) together with interest and charges (as provided by Division 8 of the Financial Code) accrued as of the date the property is returned to the pledgor up to 6 months from the transfer of title.

A sale of tangible personal property to the original pledgor is deemed to have taken place if either of the following has occurred.

- (1) The original pledgor is required to pay amounts in excess of the loan balance as of the last day of the grace period, together with interest and charges (as provided by Division 8 of the Financial Code) accrued as of the date the property is returned to the pledgor.
- (2) Title in the property has been vested in the pawnbroker for more than 6 months past the expiration of the grace period.

(2) RESALE OF VESTED PROPERTY TO A THIRD PARTY. Pawnbrokers who resell vested property to third parties, are retailers with respect to sales of the property to consumers and tax applies to the receipts from such sales.