

M e m o r a n d u m

To : Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

Date: July 12, 2011

From : Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department



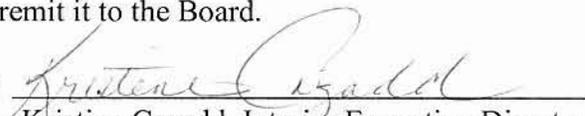
Subject : **Collection of Use Tax by Retailers - Regulation 1684**
July 26, 2011 Business Taxes Committee Meeting Agenda

The following item is on the Board's July 26, 2011 Business Taxes Committee Meeting Agenda. Board Member Yee has requested that a discussion be held and a decision be made on whether there is a need for rulemaking on Assembly Bill x1 28 regarding nexus. Attached is an Informal Issue Paper on this item.

Business Taxes Committee

Amending Regulation 1684, *Collection of Use Tax by Retailers*

Approval is sought to begin an interested parties process to discuss the need for rulemaking to implement, interpret, and make specific the provisions of ABx1 28 (Stats. 2011, Ch. 7). ABx1 28 amended Revenue and Taxation Code section 6203, which requires retailers that are engaged in business in California to collect use tax and remit it to the Board.

Approved: 
Kristine Cazadd, Interim Executive Director

JLM:rsw

Attachment: Informal Issue Paper, "Engaged in Business in this State –
Obligation to Collect Use Tax."

cc: Ms. Regina Evans
Mr. Louis Barnett
Mr. Alan LoFaso
Mr. Sean Wallentine
Ms. Marcy Jo Mandel

Ms. Kristine Cazadd, MIC 73
Mr. Randy Ferris, MIC 83
Mr. Bradley Heller, MIC 82
Ms. Diane Olson, MIC 80
Ms. Susanne Buehler, MIC 92
Mr. Geoffrey Lyle, MIC 50
Ms. Leila Hellmuth, MIC 50
Mr. Robert Wilke, MIC 50

- For Information
 For Discussion
 For Decision Making

BOARD OF EQUALIZATION
INFORMAL ISSUE PAPER

Engaged in Business in this State – Obligation to Collect Use Tax

Issue

Whether the Board should initiate an interested parties process to discuss amending Sales and Use Tax Regulation (Regulation) 1684, *Collection of Use Tax by Retailers*, to implement, interpret, and make specific the amendments made to Revenue and Taxation Code section (section)¹ 6203 by ABx1 28 (Stats. 2011, ch. 7), which changed the definition of “retailer engaged in business in this state.”

Background

Regulation 1684 requires “[r]etailers engaged in business in this state as defined in Section 6203” to register with the Board, collect California use tax from their customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board.

The Governor signed ABx1 28 on June 28, 2011, and the bill substantially revised section 6203’s definition of “retailer engaged in business in this state.” Prior to the enactment of ABx1 28, the operative provisions of section 6203, subdivision (c) provided that:

“Retailer engaged in business in this state” as used in this section and Section 6202 means and includes any of the following:

- (1) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.
- (2) Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.

¹ All future law section references used in this paper relate to the Revenue and Taxation Code.

(3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state. (Prior section 6203, subd. (c)(1)-(3).)

However, current section 6203, subdivision (c), as amended by ABx1 28, defines the term “[r]etailer engaged in business in this state” more broadly and provides that the term means “any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty.” Current subdivision (c), further provides that the term “[r]etailer engaged in business in this state” specifically includes, but is not limited to retailers engaged in the activities described in prior subdivision (c)(1) through (3) (quoted above), plus both of the following:

- Any retailer that is a member of a “commonly controlled group.” as defined in the Corporation Tax Law (section 23001 et seq.), and is a member of a “combined reporting group,” as defined by the Franchise Tax Board (FTB) in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer’s commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer (current section 6203, subd. (c)(4)); and
- “Any retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise,” but only if:
 - (1) “The total cumulative sales price from all of the retailer’s sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars (\$10,000)”; and
 - (2) “The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of five hundred thousand dollars (\$500,000)” (hereafter referred to as “qualifying agreements” for ease of reference). (Current section 6203, subd. (c)(5)(A).)

Discussion of the Issue

After the amendments to section 6203, subdivision (c), made by ABx1 28, California’s Sales and Use Tax Law now requires retailers to register with the Board and collect and remit California use tax to the fullest extent permitted under the United States Constitution. That is, retailers are now required to register with the Board and collect and remit use tax if their activities in this state give them such a “substantial nexus”² with California that California can impose a use tax collection obligation on the retailers without violating the Commerce Clause (art. 1, § 8, cl. 3) of the United States Constitution. Section 6203 is now commonly referred to as a “long-arm” statute for this reason.

Furthermore, after the amendments to section 6203, subdivision (c), made by ABx1 28, retailers will need to be able to determine:

1. Whether they are members of a “commonly controlled group” and “combined reporting group” as defined in the Corporation Tax Law and FTB regulations, respectively;

² A retailer whose only contacts with California “are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause” (Quill Corp. v. North Dakota (1992) 504 U.S. 298, 311) and would not be required to register with the Board to collect and remit use tax.

2. Whether members of their commonly controlled groups perform services in this state in connection with tangible personal property to be sold by the retailers;
3. Whether they have qualifying agreements with persons in this state; and
4. Whether they otherwise have a substantial nexus with California that requires them to register with the Board.

Therefore, staff believes that it may be helpful to retailers if the Board amended Regulation 1684 to define relevant statutory terms, such as “substantial nexus,” “commonly controlled group,” and “combined reporting group.” Further, it may be helpful if the regulation was amended to explain when a retailer does not have a “substantial nexus” with California under section 6203, as amended by ABx1 28, and provide examples of retailers that are and are not required to register with the Board to collect and remit use tax. In addition, staff believes that retailers probably need additional guidance as to whether they can continue to rely on the third and fourth paragraphs of Regulation 1684, subdivision (a), after section 6203 was amended by ABx1 28, which provide that:

The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Other Sections

Regulation 1827, *Collection of Use Tax by Retailers*, defines a “retailer engaged in business in the district” for purposes of the Transactions and Use Tax Law (section 7251 et seq.) and relies in part on some of the provisions of section 6203. If the Board authorizes staff to begin an interested parties process to discuss potential amendments to Regulation 1684, staff will also concurrently discuss any amendments to Regulation 1827 that may be required as a result of the amendments to section 6203, made by ABx1 28, with the interested parties.

Alternatives

Do not initiate an interested parties process to amend Regulation 1684.

Recommendation

Staff recommends that the Board initiate an interested parties process to allow the interested parties to discuss ABx1 28 with staff and help staff identify all the provisions of current section 6203 that may warrant interpretation and further clarification in Regulation 1684.

Critical Time Frames

Following the timeline of the standard interested parties process, proposed amendments to Regulation 1684 are anticipated to be scheduled for Business Taxes Committee discussion and authorization to publish in January 2012. The public hearing is anticipated to be held in April 2012 and review by the Office of Administrative Law is expected to be completed in June 2012.

Preparation and Reviews

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

Current as of: July 12, 2011