

Memorandum

To: Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Board Member
Honorable Bill Leonard
Honorable Steve Westly

Date: March 1, 2005

From: Jean Ograd
Acting Chief Counsel



Subject: Petitions for Amendment or Repeal of Sales and Use Tax Regulation 1699 *Permits* Subdivision (h), "Buying Companies"

Chief Counsel Matters – Tuesday, March 22, 2005

Background

On December 30, 2004, and December 31, 2004, the County of San Mateo, and the City and County of San Francisco, respectively ("Petitioners"), filed petitions pursuant to Government Code section 11340.6, requesting the Board to amend or repeal subdivision (h), "Buying Companies," of Regulation 1699, "*Permits*." Neither petition proposed language by which the section could be amended. A copy of each petition, Government Code section 11340.6 and Regulation 1699 is attached.

Petitioners waived their rights under the statute to have the Board decide this matter within thirty days. This matter is thus scheduled to be heard at the Chief Counsel Rulemaking Calendar on March 22, 2005.

These petitions grow out of United Airlines' buying subsidiary, United Aviation Fuels Company, Inc., obtaining a permit for an office at the Oakland International Airport in the City of Oakland. United Aviation Fuels Company, Inc., allocated all of the local tax revenue derived from the company's sales of jet fuel to the City of Oakland instead of to the jurisdictions of the airports where the airplanes were fueled. Petitioners allege that this result is made possible by the existence of Regulation 1699(h) and that this regulation defeats the express intent of the Legislature.

Under Revenue and Taxation Code section 7205(b)(2), if a retailer selling jet fuel has more than one sales office in this state and negotiates the sale of jet fuel in this state, the sale of the jet fuel is deemed to take place at the airport where the airplane being serviced is located.¹ Section 7204.03

¹ Statutory citations, unless stated, are to the Revenue and Taxation Code.

provides specific distribution rules for sales at multi-jurisdictional airports, including San Francisco International Airport, owned by the City and County of San Francisco and located in the County of San Mateo, generally providing for one-half the local sales tax revenue to go to the jurisdiction in which the airport is located and one-half to the jurisdiction that owns and operates the airport.

Grounds for the Petitions

While the relief requested by both petitioners is to amend or repeal subdivision (h) of Regulation 1699, the grounds advanced are not in all ways the same. A summary of the grounds alleged in the petitions follows:

1. Regulation 1699(h) Is Inconsistent with Revenue and Taxation Code sections 7205 and 7204.03.

Petitioner City and County of San Francisco, citing sections 7205 and 7204.03, alleges that the Legislature has clearly stated that jet fuel sales are deemed to take place at the airport where the airplanes being fueled are located. Petitioner avers that subdivision (h) of Regulation 1699 exceeds the Board's authority under these statutes by allowing for local sales tax revenues derived from sales of jet fuel to be distributed to a different place by the use of the device of buying companies.

2. Regulation 1699(h) Exceeds the Board's Statutory Authority.

Petitioner City and County of San Francisco alleges that subdivision (h) exceeds the Board's authority under sections 6005 and 6066 in that it effectively creates a presumption that a buying company is a legal entity separate and apart from the parent corporation that created it.

3. Regulation 1699(h) Is Inconsistent with Established Case Law.

Both Petitioners allege that subdivision (h) is invalid to the extent that it allows the issuance of seller's permits to subsidiaries that lack a true separate identity from the corporate parent in violation of the direction of the court in *Mapo, Inc v. State Board of Equalization* (1976) 53 Cal.App.3d 245.

4. Regulation 1699(h) Forces Board Staff to Issue Seller's Permits to Corporate Entities Formed for the Sole Purpose of Re-directing Local Sales Tax.

The County of San Mateo alleges that subdivision (h) fails to provide meaningful protection from schemes to re-direct local sales tax through setting up business offices by means of paper transactions.

5. Regulation 1699(h) Is Inconsistent with the Federal Anti-Head Tax Act.

49 U.S.C. section 40116(c) provides that states and cities may not tax flights or transactions relating to flights that do not take off or land within their jurisdiction. The County of San Mateo alleges that, as applied, subdivision (h) violates this statute in that it permits the taxation of sales of jet fuel for flights that do not take of or land in the City of Oakland.

Options for Board Action

Pursuant to Government Code 11340.7, upon receipt of a petition requesting the amendment or repeal of a regulation, the Board shall:

1. Deny each Petition, in whole or in part, indicating in writing why the Board has reached its decision on the merits of the petition; or
2. Initiate the rulemaking process. Schedule the matter for a public hearing in accordance with the rulemaking provisions of the Administrative Procedures Act (Gov. Code, §§ 11346 et seq.).

If the Board schedules the matter for public hearing it may, prior to setting the Public Hearing date and authorizing publication of the notice of hearing, hold public discussions of the proposal. (Gov. Code § 11346.45.) Therefore, the Board may refer the matter to the Business Taxes Committee prior to authorizing publication of the notice of hearing.

Furthermore, the Board may grant any other relief or take other such action it may determine to be warranted by the petitions. (Gov. Code § 11340.7(b).)

The decision of the Board regarding the Petition is required to be in writing and to include the reasons therefor. The decision must be transmitted to the Office of Administrative Law for publication in the California Regulatory Notice Register. (Gov. Code § 11340.7(d).)

Staff Recommendation

Staff is presenting the petitions of the County of San Mateo and the City and County of San Francisco to amend or repeal subdivision (h) of Regulation 1699. Since the Business Taxes Committee provides a forum for interested members of the public to express their views and present proposals regarding the provisions and policies related to tax and fee laws administered by the Board (Business Taxes Committee Procedures Manual 100.00), it is our recommendation that if the Board initiates the rulemaking process, the Board refer this matter to the Business Taxes Committee.

If you have any questions on these matters, please contact Assistant Chief Counsel, Janice L. Thurston at (916) 324-2588.

JO:ef

Attachments: Petition of City and County of San Francisco
 Petition of County of San Mateo
 Government Code Sections 11340.6 and 11340.7
 Regulation 1699, *Permits*

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8 Attorneys for Petitioner
CITY AND COUNTY OF SAN FRANCISCO
9

10 BEFORE THE CALIFORNIA
11 STATE BOARD OF EQUALIZATION

12 CITY AND COUNTY OF SAN
FRANCISCO,

13 Petitioner,

14 vs.
15

16 CALIFORNIA STATE BOARD OF
EQUALIZATION,

17 Respondent.

**PETITION TO AMEND OR REPEAL
BOARD OF EQUALIZATION
REGULATION 1699(h)**

(California Government Code §§11340.6,
11340.7)

18
19
20 **I. INTRODUCTION**

21 Since 1999, the City and County of San Francisco ("San Francisco") has shared the sales tax
22 revenue from jet fuel sold at San Francisco International Airport equally with San Mateo County.
23 However, beginning with the 1st quarter of 2004, the Board of Equalization ("BOARD") allocated
24 the tax revenue from United Airline's statewide jet fuel sales entirely to the City of Oakland. The
25 basis for the allocation is that jet fuel sales at San Francisco International and other airports are now
26 made by United Aviation Fuels, Inc., a "buying company", which is wholly owned by United
27 Airlines, Inc.
28

1 The diversion of local sales tax revenue to Oakland, where UAFC maintains a 580 square
2 foot office and one employee, at the expense of numerous other California jurisdictions with
3 airports, where jet fuel is actually dispensed into United Airlines planes daily was no accident. It is
4 the manifestation of a growing problem, wherein financially stressed local jurisdictions are
5 persuaded to offer lucrative deals to private industry in order to increase their own general fund
6 revenue. In this case, Oakland took advantage of a flawed regulatory provision, Regulation 1699(h)
7 which allowed it to capture statewide jet fuel sales tax revenue, simply by agreeing to pay United
8 Airlines a "kickback" of 65% of its windfall revenue due entirely to the purchasing office's location
9 in Oakland.

10 Regulation 1699(h), originally well intended, fails to achieve its objective of fairness;
11 exceeds the authority of the Revenue and Taxation Code; and creates instability for local
12 governments. Local governments are forced to compete among themselves and to bargain in the
13 open market for sales tax revenues. Regulation 1699(h) must be amended to incorporate standards
14 to prevent this type of "gamesmanship". If it cannot be so amended, it must be repealed.

16 **II. STATEMENT OF FACTS**

17 In April 2003, the City of Oakland entered into an agreement with United Air Lines, Inc., to
18 provide an incentive for the company to establish and locate a California single source purchasing
19 and resale office in Oakland. (See attached Exhibit A, Excerpts from Economic Development
20 Agreement Between The City Of Oakland, California, A Municipal Corporation And United
21 Airlines, Inc., "Agreement".) The purpose of the Agreement was to bring additional tax revenue
22 from the sale of jet fuel to the jurisdiction and to help the ailing airline company. The Agreement
23 acknowledges the Board of Equalization regulations, which treat such sales as having been
24 consummated and taxed at the location of the Sales Office in the City of Oakland. It requires the
25 City to make Economic Incentive Payments to United Airlines, measured by 65% of the sales tax
26 revenue attributable to the sales office. (Agreement, ¶¶ 5-7) The Oakland City Council passed a
27 resolution authorizing the "kick-back" to United Airlines and attesting to its desire to encourage

1 business and increase sales tax revenues for the City. (See attached Exhibit B, Resolution No.
2 77492, filed October 3, 2002.)

3 United Airlines spokesman, Jeff Green, speaking to the *Alameda Times-Star* (Alameda, CA)
4 on October 10, 2002, described the Agreement with Oakland as follows:

5 The beauty of that arrangement, United spokesman Jeff Green said, is that
6 relocation of the subsidiary is essentially paperwork. The company would
7 open a one-person sales office at Oakland International Airport, where the
8 company maintains its fleet of wide-body aircraft such as Boeing 747s and
9 767s.

10 The deal requires neither construction nor the transfer of a single drop of jet
11 fuel into or out of Oakland. The deal would just consolidate purchasing the
12 company does for the West Coast, work that can be handled by one
13 additional employee.

14 The alleged sole-source vendor, United Aviation Fuel Corporation (UAFC), leases
15 approximately 582 square feet of office space at 7700 Edgewater Drive, Suite 306, in the City of
16 Oakland. Mary Manzer, a computer consultant who worked for United Airlines prior to her
17 reassignment to UAFC in March 2004 and the sole UAFC employee at that location, reports to the
18 Tax Department of United Airlines in Chicago, Illinois. The primary contact for UAFC is Bill H.
19 Gile, Senior Staff Specialist, Excise Taxes, United Airlines Tax Department, located in Chicago.
20 Although the contract for fuel sales between United Airlines and UAFC, dated September 24, 2003,
21 was executed by Mr. Brad Hurwitz on behalf of UAFC, Mr. Hurwitz appears to never have worked
22 in the Oakland office. According to a letter from the Board's Local Revenue Allocation Section to
23 UAFC's Chicago office, as of August 2004, UAFC's sole contract was with United Air Lines, Inc.,
24 which represented 99.9% of all taxable sales made by UAFC during the fourth quarter 2003 and 1st
25 quarter 2004.

26 This arrangement suggests that the intent of opening the purchasing office in Oakland,
27 California, was not to benefit the subsidiary, but solely to derive an economic benefit for the parent
28 company, United Airlines, a company with multiple business locations in California. This
arrangement subverts the spirit of the law and the intent of the legislature.

1 **III. DISCUSSION**

2 **A. THE STATE LEGISLATURE HAS CLEARLY STATED ITS INTENT**
3 **REGARDING THE ALLOCATION OF LOCAL TAX FROM THE SALE OF**
4 **JET FUEL.**

5 Revenue and Taxation Code Section 7205 specifies the place of sale for the purposes of
6 allocating the local tax on sales of jet fuel if the principal negotiations are conducted in the state and
7 the retailer **has more than one place of business in the state**. It provides that the sale takes place
8 at the point of delivery of the fuel into the aircraft. However, if jet fuel is delivered at an airport that
9 is owned or operated by a city, county, or city and county outside the airport's geographic boundary,
10 the sales tax revenue is shared equally among the jurisdictions. (See also, Regulation 1802, Place of
11 Sale and Use for Purposes of Bradley Burns Uniform Local Sales and Use Taxes.)

12 Revenue & Taxation Code Section 7204.03, added to the Code in 1998, contains special
13 rules for multi-jurisdictional airports. In the case of San Francisco Airport, which is owned and
14 operated by San Francisco, but located in an unincorporated area of San Mateo County, one-half of
15 the local sales tax revenue is allocated to San Francisco and the other half goes to San Mateo
16 County. (See also, Regulation 1802, *supra*.)

17 If a retailer **has only one place of business in California that participates in the sale**, the
18 local sales tax from that place of business is allocated to the city, county, or city and county where
19 the place of business is located. It is irrelevant that title passes to the purchaser elsewhere or that
20 the property sold is never in the city, county or city and county in which the retailer's business is
21 located. Therefore, if a jet fuel vendor has only one place of business in California and that place of
22 business is somewhere other than at an airport, the local tax goes to the city, county, or city and
23 county in which the dealer's place of business is located, regardless of the fact that the fuel is
24 delivered and the purchaser takes title to the fuel at the airport. (See also, Regulation 1802.)

25 Revenue and Taxation Code §7204.3 was enacted by the Legislature in 1998 with full
26 knowledge of the law and the history of jet fuel sales in the state at that time. The Legislature
27 intentionally redirected the allocation of local jet fuel sales taxes from cities in which the principal
28 negotiations governing the sale of the fuel occurred to cities and counties in which airports are
located, owned and/or operated. (See attached Exhibit C, Senate Third Reading Analysis, AB 66

1 (Baca.) By this provision, the Legislature also stated its intention that the revenue derived from jet
2 fuel sales at San Francisco International Airport be shared by the City and County of San Francisco
3 and San Mateo County. Three years later, the Board adopted regulation 1699(h). The Board should
4 correct this abrogation of the clear intent of the legislature by amending its regulation to conform to
5 the statute.

6 **B. REGULATION 1699(h) CONFLICTS WITH AND EXCEEDS THE BOARD'S**
7 **STATUTORY AUTHORITY.**

8 UAFC is a "buying company", which purchases fuel for United Airlines. A buying
9 company is defined in the Board's regulations as:

10 "a legal entity that is separate from another legal entity that owns, controls, or is otherwise
11 related to the buying company and which has been created for the purpose of performing
12 administrative functions, including acquiring goods and services for the other entity."
(Regulation 1699(h))

13 A buying company is not considered a separate legal entity, and is not issued a seller's permit by the
14 board, if its only purpose is to redirect sales tax revenue. In order to show that it is formed for a
15 purpose other than the redirection of local tax under regulation 1699(h), a buying company must
16 either (1) add a markup to its cost of goods sold in an amount sufficient to cover its operating and
17 overhead expenses and/or (2) issue invoices or otherwise account for the transactions.

18 Regulation 1699(h) was originally intended to "discourage activities designed to divert local
19 tax from one city to another" and to "ensure a uniform interpretation of the Revenue and Taxation
20 Code." (See, Issue Paper No. 01-033, Proposed Regulatory Changes Regarding the Issuance of a
21 Seller's Permit to "Buying Companies" and to Sellers' Websites, Regulation 1699, Permits, p.5.)
22 However, as it is currently written, it goes astray of its intended goals and does an injustice to local
23 sales tax administration.

24 Regulation 1699(h) was promulgated pursuant to California Revenue and Taxation Code
25 Section 6066, which reads in pertinent part:

26 (a) Every person desiring to engage in or conduct business as a seller within
27 this state shall file with the board an application for a permit for each place of
28 business. Every application for a permit shall be made upon a form
prescribed by the board and shall set forth the name under which the
applicant transacts or intends to transact business, the location of his place or

1 places of business, and such other information as the board may require. An
2 application for a permit shall be authenticated in a form or pursuant to
3 methods as may be prescribed by the board. The applicant shall state that the
applicant will actively engage in or conduct business as a seller of tangible
personal property.

4 The term "Buying Company" does not appear in section 6066 or in any other provision of
5 the Revenue and Taxation Code. Although regulation 1699(h) purports to make specific the
6 circumstances under which the Board will issue a seller's permit, it goes far beyond the language of
7 the statute. It creates a new concept, the "buying company", and prescribes the circumstances under
8 which the company will be recognized as a separate legal entity. In doing so, the board exceeds its
9 authority.

10 The Board is empowered to make all rules necessary to administer and enforce the Sales and
11 Use Tax Law. Rev & Tax Code §7051. In doing so it may "adopt regulations to implement,
12 interpret, make specific or otherwise carry out the provisions of" the statute. California
13 Government Code §11342.2. *Agnew v State Board of Equalization* (1999) 21 Cal. 4th 310, 321.
14 Any regulation adopted by the Board is required to be "...consistent and not in conflict with the
15 statute and reasonably necessary to effectuate the purpose of the statute." Gov Code §11342.2. As
16 the court stated in *Ontario Community Foundations, Inc v. State Board of Equalization* (1984) 35
17 Cal. 3d 811, at p. 816-817

18 ...there is no agency discretion to promulgate a regulation which is
19 inconsistent with the governing statute....Administrative regulations that
20 violate acts of the Legislature are void and no protestations that they are
merely an exercise of administrative discretion can sanctify them.

21 The Revenue and Taxation Code establishes requirements for "Every **person**¹ desiring to
22 engage in or conduct business as a seller...." Regulation 1699 violates the law by completely
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24
25 ¹ 6005. "Person." "Person" includes any individual, firm, partnership, joint venture,
26 limited liability company, association, social club, fraternal organization, corporation,
27 estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in
combination acting as a unit.

1 disregarding the terms of the statute and setting out a different set of criteria for a type of entity,
2 which is not described in the Code.

3 The criteria contained in regulation 1699(h) are so minimal that they severely undercut the
4 original purpose of the regulation. The regulation establishes a presumption that if a company
5 either adds a markup sufficient to cover its overhead to its cost of goods sold, or issues invoices,
6 that it is formed for a purpose other than the redirection of local tax. But, even if a company does
7 neither of these things, it may still be a legitimate buying company under the regulation. The
8 authorizing statute does not authorize this presumption, nor is the presumption consistent with the
9 general tax law. Regulation 1699(h) does not implement, interpret, or make specific provisions of
10 the Revenue and Taxation Code. It exceeds the legislative mandate; does away with the prior
11 standard for establishing a separate legal entity and, in its laxity, conflicts with the spirit and
12 purpose of the Revenue and Taxation Code.

13 **C. REGULATION 1699(h) SANCTIONS BLATANT MANIPULATION AND**
14 **AVOIDANCE OF THE SALES TAX LAW.**

15 An administrative agency, such as the State Board of Equalization is granted broad
16 discretion in adopting regulations, but it may not use its authority to "alter, enlarge, subvert or
17 impair the act being administered. *Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43
18 Cal. 3d 1379. The requirements of regulation 1699(h) are so minimal that they encourage schemes
19 to divert sales tax revenue, create instability and competition among local jurisdictions and sanction
20 gifts of scarce public resources to private entities.

21 Prior to the adoption of regulation 1699(h) there was a clear and adequate standard for
22 determining when a sale takes place. That standard is outlined in *Mapo, Inc. v. State Board of*
23 *Equalization* (1975) 53 Cal. App. 3d 245. Regulation 1699(h) is inconsistent with *Mapo* because it
24 limits the board inquiry into a company's business operations and hampers the ability to determine if
25 a company is a legal entity separate and distinct from its parent.

26 In *Mapo*, the board challenged a trial court decision that Mapo, a wholly owned subsidiary
27 of Walt Disney Productions, and Walt Disney Productions were not separate entities, and that
28 transactions between the companies were therefore not taxable sales. The Court of Appeal held that

1 the taxpayer corporation was not a true separate entity from its corporate grandparent; therefore the
2 transactions between them were not sales within the meaning of the statute and were not subject to
3 tax. The court reasoned that:

4 Mapo existed as a separate corporation in name only, for in its six years it did
5 nothing for its own account or for anyone except its corporate relatives. It
6 acted solely on orders from Productions. It owned no materials, kept no
7 books, bore no liability for its operation, recorded no profits. Its sole reason
8 for existence was to make the fabrication of animated mechanical figures
9 possible by reaching agreements with a single labor union that would be
10 vertical, i.e., any person could work on any job and be classified and paid
11 accordingly. Mapo appeared, simplified these union negotiations, acted as
12 conduit for payment of salaries for certain Productions personnel, and
13 disappeared without noticeable effect. *Id.*, at p. 249.

14 Mapo added a mark-up to its cost of goods sold and accounted for its transactions, but those
15 factors were not sufficient to make it a separate entity. The factors considered by the Court in
16 deciding to disregard Mapo included:

- 17 1. The length of time the corporations separately exist;
- 18 2. The maintenance of distinct corporate identities;
- 19 3. The independent business purposes of the separate corporations; and
- 20 4. The observance of formalities of purchase and sale between the corporations.
21 *Mapo*, at p 248.

22 Board staff relied on the Mapo case in their opinion regarding the proposed changes to the
23 regulation, stating "the courts have declared that when two separate legal entities have such identity
24 of interest as to be separate in name only, the Board must regard them as one entity and disregard
25 sales made between each other." *Issue Paper 01-033*, at p. 7.

26 Under *Mapo*, it is unlikely that United Aviation Fuel Corporation would be considered a
27 separate and distinct entity from United Airlines. Its sole reason for existence is to serve United
28 Airlines by diverting local sales tax revenue to United through its agreement with the City of
Oakland. Its sales contracts appear to be identical to prior United Airlines contracts. Its single
employee is supervised and directed by United Airlines management in Chicago. In fact, if UAFC
disappeared, the only noticeable effect would be a change in the sales tax allocation.

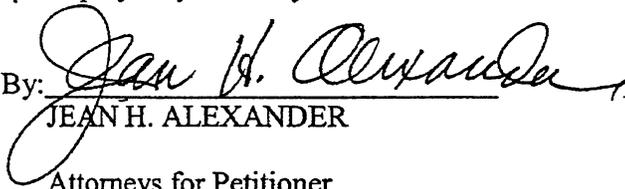
1 **IV. CONCLUSION**

2 For the above-described reasons, and for those previously cited to the Board in the Petition
3 of San Mateo County, the City and County of San Francisco respectfully requests that the Board
4 amend or repeal regulation 1699(h).

5
6 Dated: December 31, 2004

Respectfully submitted,

7 DENNIS J. HERRERA
City Attorney
8 JULIE VAN NOSTERN
Chief Tax Attorney
9 JEAN H. ALEXANDER
Deputy City Attorney

10
11 By: 
12 JEAN H. ALEXANDER

13 Attorneys for Petitioner
14 CITY AND COUNTY OF SAN FRANCISCO
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EXHIBIT
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ECONOMIC DEVELOPMENT AGREEMENT
BETWEEN THE CITY OF OAKLAND, CALIFORNIA, A MUNICIPAL
CORPORATION AND
UNITED AIRLINES, INC.

This Economic Development Agreement ("Agreement") is entered into as of this 1st day of April 2003, by and between the City of Oakland ("City"), a California municipal corporation, and United Air Lines, Inc. (Referred to herein as the "Company").

RECITALS

1. Whereas, the City of Oakland is a municipal corporation under the Constitution and laws of the State of California and is authorized to enter into binding contractual agreements as a municipal corporation; and
2. Whereas, City wishes to be competitive in retaining companies like Company; and
3. Whereas, City desires to maximize sales, property and business tax revenues; and
4. Whereas, City wants to maintain its status as an excellent, low cost municipality in which to operate a business; and
5. Whereas, City seeks to provide financial incentives for companies that enhance the economic environment of City; and
6. Whereas, Company seeks to locate its operations in jurisdictions that facilitate cost reductions; and
7. Whereas, Company currently employs over 1,000 people within its operations in Oakland, of which a great majority are union employees represented by the International Association of Machinists and Aerospace Workers (IAMAW); and
8. Whereas, current salaries paid by Company to its workforce employed at Oakland range from approximately \$20,000 to more than \$100,000 which currently include full benefit packages that encompass, but are not limited to, life, health, dental, and retirement; and
9. Whereas, Company's workforce is highly skilled and currently includes management and administration, engineers and mechanics including over 700 wide-body aircraft (747 and 777) maintenance mechanics; and
10. Whereas, Company currently provides its workforce with continual training directed by several full-time trainers; and

11. Whereas, Company currently contributes substantial property taxes to City; and
12. Whereas, Company currently contributes substantial business license taxes to City; and
13. Whereas, Company currently leases over 324,000 square feet at the Oakland airport including its maintenance facilities for which it pays over \$4.8 million annually to the Port of Oakland; and
14. Whereas, Company purchased over \$12 million in goods and services from Oakland vendors in 2001; and
15. Whereas, Company has consistently awarded on-site construction projects to local, unionized contractors; and
16. Whereas, Company's current presence in City helps to promote the health, safety and welfare of City's residents and businesses and enhance the economic well-being of City by providing significant, long-term revenue streams which provide for necessary safety and recreational services and by providing a source of high-quality jobs for municipal residents; and
17. Whereas, Company's current presence in City stimulates, enhances and otherwise contributes to the local economy by way of direct and indirect investments, job training, preservation of current property, sales, and business license tax bases; and
18. Whereas, Company is under severe pressure to reduce costs and eliminate all unnecessary costs and facilities; and
19. Whereas, the tragic events of September 11, 2001 have increased pressure on and created a unique urgency for the Company to reduce costs; and
20. Whereas, on December 9, 2002 (the "Filing Date"), Company filed a voluntary petition for reorganization relief pursuant to Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §101 *et seq.*, as amended, in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division, and since the Filing Date, has operated its business as a debtor-in-possession (as defined in Section 1101 of Bankruptcy Code) as authorized by Sections 1107 and 1108 of the Bankruptcy Code since the Filing Date; and
21. Whereas, the City acknowledges and agrees that, by entering into this post Petition Agreement, the Company does not waive or release (and to the contrary, expressly reserves) any and all rights afforded to the Company under Chapter 11 of the Bankruptcy Code; and

22. Whereas, Company anticipates maintaining a certain level of operations and also contemplates establishing a subsidiary (Sales Office) that will administer its sales and other related activities within the corporate limits of the City; and
23. Whereas, Sales Office will stimulate, enhance, and otherwise contribute to the local economic and commercial activity in City, enhance the local tax base by increasing business license taxes, sales, and other taxes payable to City, and otherwise generally improve the economic vitality of City; and
24. Whereas, without this Agreement, Company would not cause the establishment of this new operation in City and likely would establish this new operation elsewhere; and
25. Whereas, the taxes received by City as a result of this Sales Office are expected to enhance City's ability to finance many projects for the betterment of the welfare of the residents of City, and for various public improvements and uses as may, from time to time, be determined by the City Council of Oakland; and
26. Whereas, by this Agreement, City and Company desire to set forth the terms under which Company will receive certain economic incentives, as defined and calculated pursuant to Section 4 of this Agreement (the "Economic Incentive") for establishing said Sales Office within Oakland city limits; and
27. Whereas, City considers the aforementioned potential benefits from establishing the Sales Office in City as key contributors in supporting City's economy; and
28. Whereas, City is entering into the Agreement under its authority as an incorporated municipality; and
29. Whereas, City and Company acknowledge and agree that the consideration that is to be exchanged pursuant to this Agreement is fair, just, and reasonable.

NOW, THEREFORE, FOR GOOD AND VALUABLE CONSIDERATION, THE RECEIPT AND SUFFICIENCY OF WHICH ARE HEREBY ACKNOWLEDGED, IT IS AGREED AS FOLLOWS:

AGREEMENT

1. Incorporation of Recitals. The Recitals to this Agreement are hereby declared to set forth the findings of the parties and are incorporated herein as if fully set forth in this Section 1.
2. Establishment of Purchasing and Resale Business. Company agrees to establish reasonably promptly its California single source purchasing and resale business for

the purchase and resale of jet fuel and other commodities (as determined by Company) ("Sales Office") within the corporate limits of the City. The measurement of Economic Incentive payments as provided in this agreement shall commence with and be measured from the date that the Company establishes such Sales Office within the corporate limits of the City and the City receives sales taxes from Company's establishment of such Sales Office within the corporate limits of the City. The City's duty to make Economic Incentive payments shall cease upon the termination of the Company's maintenance of its Sales Office in the City of Oakland, or upon the termination of its Sales Office as its single source purchasing and resale business for the purchase and resale of jet fuel and other commodities, or upon the change of the law or California Board of Equalization Regulations (or upon a determination pursuant to the law or Regulations) relating to jet fuel sales so that such sales are no longer treated as having been consummated and taxed at the location of the Sales Office in the City of Oakland.

3. Disclaimer. Parties acknowledge the difficulty of determining with precision the level of benefits Company affords to City as a result of its current and anticipated activities. Parties therefore agree that the level of sales tax receipts derived by City as a result of the Sales Office's activities in City represents a fair and readily administrable proxy for measuring all of the direct and indirect benefits generated by the Company. Moreover, City wishes to ensure that any Economic Incentive is based upon future receipts generated by Company's newly established single source purchasing and resale business for the purchase and resale of jet fuel and other commodities in the City of Oakland and will not require City to undertake any new debt. To that end the Economic Incentive shall be determined as set forth in the following sections.
4. Computation of Economic Incentive.

City and Company hereby agree that City will provide Company an economic incentive measured as a fixed portion of the quarterly distribution of sales taxes received by City that is attributable to the Sales Office's sales within the City from the newly established Sales Office in the City of Oakland ("Local Share") as follows:

- i. On a quarterly basis, Company shall furnish to City's Treasurer or the Treasurer's designee (a) copies of Sales and Use Tax Return BOE-401-A, filed by the Sales Office with the California State Board of Equalization, and (b) a disbursement request.
- ii. On a quarterly basis, but in any event no later than thirty (30) business days after City's receipt of its quarterly distribution of sales taxes from the California State Board of Equalization or any other, including successor, duly constituted tax authority, the City shall cause the City's Treasurer or the Treasurer's designee to disburse to

Company an amount equal to the amount shown on the disbursement request furnished by Company, which amount shall be calculated as follows:

1. For the effective length of this Agreement, the City shall grant to the Company as an Economic Incentive payment an amount equal to sixty-five (65) per cent of the Local Share as provided for herein.
 2. Company will be paid, no later than thirty (30) business days after City receives its quarterly distributions for the Local Share, as described in Section 34 (ii) above, the amount described in section 34 (ii)(1) above.
 3. City shall remit the quarterly distribution to:
United Air Lines, Inc.
Director of Excise and Property Taxes
P.O. Box 66100 WHQCT
Chicago, Illinois 60666
5. Amended Tax Returns. In the event that the Sales Office amends any tax returns previously submitted to City pursuant to this Agreement, Company agrees, promptly upon filing such amended tax return, to forward a photocopy of such amended tax returns to City, clearly identifying them as an amendment of a tax return previously submitted to City, and to submit an amended disbursement request relating thereto.
6. Audit - Reconciliation. Each disbursement from City to Company shall be accompanied by a statement, executed by City's Treasurer or the Treasurer's designee, setting forth the calculations made to determine the amount of such disbursement. City's Treasurer shall also issue to Company a statement setting forth all disbursements made to date to Company for each calendar year. Each party shall have the right to contest any of the calculations or information contained in said statements or Company's disbursement request upon written notice to the other party within sixty (60) days following any disbursement. If the challenging party can show, to the reasonable satisfaction of the other party within sixty (60) days of such written notice, that the amount disbursed to Company was incorrect, either City shall disburse to Company the correct amount due, or Company shall reimburse City for any disbursement received in excess of the correct amount, as the case may be. Provided further, that if the Sales Office files an amended Sales and Use Tax return, as contemplated in Section 3 of this Agreement, which amended return is approved by the California State Board of Equalization, then any disbursements to Company for the months affected by the amended returns shall be adjusted accordingly. In the event that the parties cannot agree upon the proper disbursement amount, the parties will submit to binding arbitration pursuant to Section 10.

7. Audit – Adjustment. In the event that the Sales Office is audited by the California State Board of Equalization, and such audit results in adjustments to tax returns previously submitted to City by Company pursuant to this Agreement, upon final disposition of any changes made as a result of such audit, City will deem such adjustments to be an amended return, and Company shall submit to City an amended disbursement request pursuant to Section 4 of this Agreement and either City shall disburse to Company the correct amount due, or Company shall reimburse City for any disbursement received in excess of the correct amount, as the case may be. During the pendency of any audit or investigation City may withhold any payments due under the terms of this Agreement until a final determination of such audit or investigation is completed and any adjustments to tax returns previously submitted become final.
8. Confidentiality. The parties acknowledge that the information contained in any tax return is confidential, proprietary to Company and the Sales Office, and agree that, to the fullest extent permitted by law, no documents, including tax returns, or other information provided by Company or the Sales Office to City, its agents and representatives pursuant to or with regard to the provisions of this Agreement, shall be released to or otherwise made available to any third person, corporation, organization or association unless disclosure is permitted pursuant to a written order of a court of competent jurisdiction or the prior written consent of Company. City shall offer Company the opportunity to defend any claim made by any third party against City for release of such confidential documents or information. In the event that a nonparty to this Agreement seeks disclosure of any information concerning the terms of this Agreement from City, City shall promptly, but in any event, no later than two (2) business days after City receives such request, notify Company in writing of such request, identifying the party making the request and the information sought by such party. In the event that Company contests such disclosure request, Company shall pay and hold City harmless from all costs and expenses including reasonable attorneys' fees of City, the parties hereto may incur in contesting such disclosure request. All tax returns, documents and other information provided to City by Company shall be returned to Company immediately upon termination of this Agreement.
9. Term. The provisions of this Agreement shall govern the rights and obligations of Company and City for a period of ten (10) years, effective as of the date first set forth herein above and subject to the annual determinations as provided for herein. The initial term of this Agreement shall be for one (1) year commencing with the effective date of this Agreement set forth herein above. Each year thereafter, not less than sixty (60) days before the anniversary date of the effective date of this agreement, the City shall make such determinations as are legally required to extend this Agreement for another one (1) year period and determine whether to extend this Agreement for such additional one (1) year period. To the extent required by law, for each year during this ten (10) year period, the City agrees that it will make such budget and appropriation determinations as are required to comply with this

Agreement. Should the City determine not to extend this Agreement for an additional one (1) year period it shall give notice to Company not less than 30 days before the end of the then current one (1) year term of this Agreement. Nothing in this Agreement shall be construed to require Company to continue doing business in the City for any length of time. However, Company shall give City no less than sixty (60) days notice of its intent to cease maintaining its Sales Office in the City of Oakland. This Agreement shall terminate immediately, and except as provided for in the succeeding sentence, without liability (monetary or otherwise) to either party, in the event that Company no longer operates the Sales Office within the corporate limits of the City. The rights, responsibilities and liabilities of the parties arising under this Agreement shall not survive the termination of this Agreement, except (a) to the extent that any obligations hereunder accrued prior to termination and (b) any obligations pursuant to Section 7, Confidentiality.

10. Regulatory Compliance. Company will make a good faith effort to fulfill its obligations under this Agreement in such manner that it will at all times comply with the terms and provisions of any and all applicable California statutes and laws and regulations issued by the State of California Board of Equalization, including, but not limited to, those relating to single source purchasing and resale business for the purchase and resale of jet fuel and other commodities, and shall notify City promptly if it is notified of any challenge, investigation or Audit relating thereto.

11. Conflict of Interest.

The following protections against conflict of interest will be upheld:

- i. Company certifies that no member of, or delegate to the Congress of the United States shall be permitted to share or take part in this Agreement or in any benefit arising therefrom.
- ii. Company certifies that no member, officer, or employee of the City or its designees or agents, and no other public official of the City who exercises any functions or responsibilities with respect to the programs or projects covered by this Agreement, shall have any interest, direct or indirect in this Agreement, or in its proceeds during his/her tenure or for one year thereafter.
- iii. Company shall immediately notify the City of any real or possible conflict of interest between work performed for the City and for other clients served by Company.
- iv. Company warrants and represents, to the best of its present knowledge, that no public official or employee of City who has been involved in the making of this Agreement, or who is a member of a City board or commission which has been involved in the making of this Agreement whether in an advisory or decision-making capacity, has or will receive a direct or indirect financial interest in this Agreement in violation of the rules contained in California

EXHIBIT
B

FILED *B*
OFFICE OF THE CITY CLERK
OAKLAND

OAKLAND CITY COUNCIL

02 OCT -3 PH 2:14

RESOLUTION NO. C. M. S.

77498

RESOLUTION AUTHORIZING THE CITY MANAGER TO NEGOTIATE, ENTER INTO, AND EXECUTE AN ECONOMIC DEVELOPMENT AGREEMENT BETWEEN THE CITY OF OAKLAND AND UNITED AIR LINES, INC., WHICH WILL PROVIDE FOR BUSINESS INCENTIVE PAYMENTS TO UNITED AIR LINES, INC. OVER A NO LESS THAN A TEN YEAR PERIOD THAT WILL BE EQUIVALENT TO 65 PERCENT OF THE SALES TAXES GENERATED BY ITS SINGLE SOURCE PURCHASING AND RESALE BUSINESS TO BE LOCATED IN THE CITY OF OAKLAND.

WHEREAS, the City Council desires to improve the business climate and facilitate opportunities for businesses in the City of Oakland; and

WHEREAS, the City Council desires to increase the revenues available to the City from tax revenues generated by businesses in the City of Oakland; and

WHEREAS, the City wishes to encourage businesses to maintain and expand their operations in the City of Oakland; and

WHEREAS, the City Council finds that the payment contract proposed pursuant to the agreement authorized hereunder is legal, and presents no recourse liability to the City of Oakland,

NOW, THEREFORE, BE IT

RESOLVED: That the City Council hereby authorizes the City Manager to negotiate, enter into and execute an economic development agreement between the City of Oakland and United Air Lines, Inc. to maintain its business operations and locate its single source jet fuel purchasing and resale business in the City of Oakland and pay United Air Lines, Inc. an amount equivalent to 65% of the sales tax equivalent generated by the business newly located in the City of Oakland as received by the City over a no less than ten year period; and be it

FURTHER RESOLVED: That the City Council hereby authorizes the establishment of a special project to receive the sales tax funds generated by the business newly located in the City of Oakland and authorizes the disbursement of the funds as provided for in the agreement entered into between the City of Oakland and United Air Lines, Inc. with revenue expectations and disbursement appropriation amounts budgeted under the special project beginning in 2003-05; and be it

EXHIBIT **B**

FURTHER RESOLVED: That the City Manager or his designee is authorized to make adjustments to revenue and expenditure appropriations pertaining to this agreement, based on actual and anticipated future revenue receipts from United; and be it

FURTHER RESOLVED: That the City Manager or his designee is authorized to negotiate, execute and submit all documents, applications, agreements, and amendments, which may be necessary or convenient to implement this Resolution; and be it

FURTHER RESOLVED: That the Office of the City Attorney shall approve the agreement and all such other documents, applications, agreements, and amendments as to form and legality and a copy will be placed on file at the Office of the City Clerk.

OCT 29 2002

IN COUNCIL, OAKLAND, CALIFORNIA, _____, 2002

PASSED BY THE FOLLOWING VOTE:

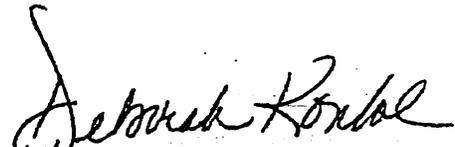
AYES- BRUNNER, CHANG, ~~MAYNE~~, REID, SPEES, WAN and PRESIDENT DE LA FUENTE - 7

NOES- Mayne - 1

ABSENT- 0

ABSTENTION- 0

ATTEST:


CECEDA FLOYD
City Clerk and Clerk of the Council
of the City of Oakland, California

C

A report and recommendation from the Director, Community and Economic Development Agency, regarding a proposed resolution authorizing the City Manager to negotiate, enter into, and execute an Economic Development Agreement between the City of Oakland and United Air Lines, Inc., which will provide for business incentive payments to United Air Lines, Inc. over a no less than a ten year period that will be equivalent to 65 percent of the sales taxes generated by its single source purchasing and resale business to be located in the City of Oakland (002944)

A motion was made that this matter be Accepted. The motion carried by the following vote:

Votes: Councilmember Absent: Chair Wan
Councilmember Aye: Member De La Fuente, Member Spees and Member Reid

C-1

A resolution authorizing the City Manager to negotiate, enter into, and execute an Economic Development Agreement between the City of Oakland and United Air Lines, Inc., which will provide for business incentive payments to United Air Lines, Inc. over a no less than a ten year period that will be equivalent to 65 percent of the sales taxes generated by its single source purchasing and resale business to be located in the City of Oakland (002944a)

A motion was made that this matter be Accepted. The motion carried by the following vote:

Votes: Councilmember Absent: Chair Wan
Councilmember Aye: Member De La Fuente, Member Spees and Member Reid
The Committee moved, seconded and carried a motion to accept the report and resolution on Items C and C-1.

D

A report and recommendation from the Chief, Oakland Police Department, regarding a proposed resolution authorizing the City Manager or his designee to enter into an agreement with Public Communications Services, Inc. for the no-cost installation and maintenance of an inmate telephone system at the Oakland City Jail in return for a forty percent (40%) commission on all billable revenues to be deposited to the Inmate Welfare Fund (002959)

A motion was made that this matter be Accepted. The motion carried by the following vote:

Votes: Councilmember Absent: Chair Wan
Councilmember Aye: Member De La Fuente, Member Spees and Member Reid

D-1

A resolution authorizing the City Manager or his designee to enter into an agreement with Public Communications Services, Inc. for the no-cost installation and maintenance of an inmate telephone system at the Oakland City Jail in return for a forty percent (40%) commission on all billable revenues to be deposited to the Inmate Welfare Fund (002959a)

A motion was made that this matter be Accepted. The motion carried by the following vote:

Votes: Councilmember Absent: Chair Wan
Councilmember Aye: Member De La Fuente, Member Spees and Member Reid
The Committee moved, seconded and carried a motion to accept the report and resolution on Items D and D-1.

7-C-1

A resolution authorizing the City Manager to negotiate, enter into, and execute an Economic Development Agreement between the City of Oakland and United Air Lines, Inc., which will provide for business incentive payments to United Air Lines, Inc. over a no less than a ten year period that will be equivalent to 65 percent of the sales taxes generated by its single source purchasing and resale business to be located in the City of Oakland (002944a)

A motion was made that this matter be Adopted. The motion carried by the following vote:

Votes: ORA\Councilmember Nos: 1 - Councilmember Mayne
ORA\Councilmember Ayes: 7 - Councilmember Brunner, Councilmember Wan, Councilmember Nadel, Councilmember Spees, President of the Council De La Fuente, Vice Mayor Reid and Councilmember Chang
The City Clerk advised the Council that one public speaker pulled Items 7-C-1, 18, 20, and 24. The speaker was asked to speak on all items at once.

The following public speaker spoke on Items 7-C-1, 18, 20, and 24, and did not indicate a position:

- Sanjiv Handa

Agency/Councilmember Spees made a motion, seconded by Vice Mayor, to adopt the resolutions on Items 7-C-1 and 24, and approve the reports on Items 18 and 20, and hearing no objections, all members present were recorded as voting: Ayes: Agency/Councilmember: Brunner, Chang, Mayne, Nadel, Reid, Spees, Wan and President of the Council De La Fuente -8;

Councilmember Mayne registered a No vote on Item 7-C-1; Ayes: -7, Noes: -1 (Mayne)

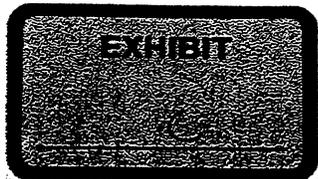
*Resolution Number 77498 C.M.S.
Contract Number 02-1436*

7-D-1

A resolution authorizing the City Manager or his designee to enter into an agreement with Public Communications Services, Inc. for the no-cost installation and maintenance of an inmate telephone system at the Oakland City Jail in return for a forty percent (40%) commission on all billable revenues to be deposited to the Inmate Welfare Fund (002959a)

A motion was made that this matter be Adopted. The motion carried by the following vote:

Votes: ORA\Councilmember Ayes: 8 - Councilmember Brunner, Councilmember Wan, Councilmember Nadel, Councilmember Spees, President of the Council De La Fuente, Councilmember Mayne, Vice Mayor Reid and Councilmember Chang
*Resolution Number 77499 C.M.S.
Contract Number 02-1437*



SENATE RULES COMMITTEE
Office of Senate Floor Analyses
1020 N Street, Suite 524
(916) 445-6614 Fax: (916) 327-4478

AB 66

THIRD READING

Bill No: AB 66
Author: Baca (D), et al
Amended: 6/4/98 in Senate
Vote: 21

SENATE REVENUE & TAXATION COMMITTEE : 5-1, 4/1/98
AYES: Alpert, Hurtt, Karnette, Knight, McPherson
NOES: Kopp
NOT VOTING: Burton, Greene, Lee

SENATE LOCAL GOVERNMENT COMMITTEE : 6-1, 6/7/98
AYES: Ayala, Brulte, Costa, Johnston, Kopp, Polanco
NOES: Rainey
NOT VOTING: Watson, Craven

SENATE APPROPRIATIONS COMMITTEE : 8-2, 7/13/98
AYES: Alpert, Calderon, Dills, Hughes, Karnette, Kelley,
McPherson, Vasconcellos
NOES: Johnson, Mountjoy
NOT VOTING: Johnston, Burton, Leslie

ASSEMBLY FLOOR : 67-8, 1/28/98 - See last page for vote

SUBJECT : Local sales and use taxes: jet fuel

SOURCE : The author

DIGEST : This bill revises the rules used to allocate jet fuel sales tax revenue to local governments. The bill allocates local tax revenue from sales of jet fuel to the local jurisdiction where the fuel is delivered into the aircraft (i.e., to the airport's jurisdiction). For

multijurisdictional airports, this bill specifies the allocation of revenue to the jurisdictions involved.

This bill applies to allocations made on or after September 1, 1998.

ANALYSIS : Existing law imposes a sales tax on the transfer of tangible personal property. Of the basic 7.25% sales tax rate, 1.25% is locally levied. A 1% rate is levied by both cities and the county in which the cities are located. The 1% county rate is deducted from the 1% city rate if the sales takes place within a city. In other words, if the sale takes place in an incorporated area, the city gets the revenue from the 1% levy; if the sale takes place in an unincorporated area, the county receives the revenue. The remaining 0.25% is levied by the county for transportation purposes.

Place of sale is the retailer's business location. If the retailer has more than one business location, a sale is deemed to occur at the place of business where the principal negotiations are conducted. (Regulation 1802)

This bill establishes a new method for allocating revenues from the 1-1/4% local rates when jet fuel is sold to aircraft. For sales of this product, revenues will no longer be allocated to the jurisdiction in which the principal negotiations are conducted. Instead, this bill provides four methods for allocating local tax based on which local jurisdiction owns the airport where aircraft are refueled and in which jurisdiction the airport is located:

1. Single Jurisdiction : If the airport is located within the same jurisdiction that owns the airport, the 1% and the 1/4% rates are allocated to that jurisdiction.
2. Multi-jurisdiction : If the airport is located in a different jurisdiction than the jurisdiction that owns the airport, the 1% rate and the 1/4% rates are split equally between each jurisdiction.
3. San Francisco International Airport : For this airport, the 1% and the 1/4% rates are split equally between the County of San Mateo and the City and County of San Francisco.
4. Ontario International Airport : For this airport, the City of Ontario receives the 1% rate and the County of San Bernardino receives the 1/4% rate. The County of Los

Angeles, which owns the airport, receives no tax revenues.

This change applies to allocations made on or after September 1, 1998.

The Senate Local Government Committee states, "Under current law, the BOE allocates most jet fuel sales tax based on where the principal negotiations occur. AB 66 allocates most of these taxes based on where the recipient aircraft is located and what jurisdiction owns and operates the airport. Both approaches are arbitrary. AB 66 benefits cities and counties that own and operate or house airports, but reduces the revenues to the communities that contain the fuel sales are usually negotiated. While state law prohibits the divulging of confidential taxpayer

information, the Board of Equalization predicts that AB 66 will benefit the cities of Burbank, Los Angeles, Oakland, Ontario, and San Diego, and the counties of Los Angeles, Sacramento, and San Mateo. Alternately, the BOE predicts that the City of Laguna Hills and the City and County of San Francisco will lose sales tax revenues. Is the policy link between jet fuel purchases and sales tax allocation more reasonable under AB 66?

"Here are examples of how AB 66's formulas work:

"1. Los Angeles International Airport (LAX). The City of Los Angeles owns and operates LAX, which is also located within the City's boundaries. Under AB 66, the City would receive all the sales taxes from the 1.25% rate.

"2. Needles Airport. San Bernardino County owns the Needles Airport, which is located in the City of Needles. The applicable sale tax is 1.25%. Under AB 66, 0.625% goes to the County because it owns and operates the airport. The other 0.625% also goes to the County (because it's also the county where the aircraft is located), but an amount of sales tax attributable to one-half of the City's 1% rate would be allocated to the City of Needles because its boundaries also include the airport. "Nine other airports are owned by a county but located within one of its cities: Brackett Field, El Monte, and Fox Airports (Los Angeles County); Apple Valley Airport (San Bernardino County); Gillespie Field and McClellan-Palomar Airports (San Diego County), San Carlos Airport (San Mateo County), and Camarillo and Oxnard Airports (Ventura County). In addition, the San Francisco and Ontario International Airports have special allocation formulas under AB 66. "

The following is a table illustrating how this bill would work relative to current law:

Single Jurisdiction : Airport is located in the jurisdiction that owns the airport -- e.g., Los Angeles International Airport is located in the unincorporated area of Los Angeles County, which owns LAX

Location of where Airport	Location of Principal Negotiations	Location of Airport	Fuel is Pumped
Owner.....			
Current law	1.25%	-0-	-0-
AB 66	-0-	-0-	1.25%
(Los Angeles Co.)			

Multi-jurisdiction : Airport is located outside jurisdiction that owns the airport -- e.g., Needles Airport is located in the City of Needles and owned by the County of San Bernardino

Location of Airport	Location of Principal Negotiations	Location of Airport where Fuel is Pumped
<u>Owner</u>		
Current law AB 66	-0- 1.25%	-0- -0- 0.625% 0.625%
Co)	(City of Needles)	(San Bdo)

San Francisco International Airport : Airport is located in the unincorporated area of San Mateo County and owned by the City and County of San Francisco

Location of Airport	Location of Principal Negotiations	Location of Airport where Fuel is Pumped
<u>Owner</u>		

Current law AB 66	-0- 1.25%	-0- -0- 0.625% 0.625%
	(San Mateo Co.)	(Ci/Co SF)

Ontario Airport : Airport is located in the City of Ontario in San Bernardino County and owned by Los Angeles County

Location of where Pumped	Location of Principal Negotiations	Location of Airport Fuel is
<u>Owner</u>		
Current law AB 66	1.25% -0-	-0- -0- 1.25% -0-
	(1.00% Ontario)	(.25% San Bdo Co)

FISCAL EFFECT : Appropriation: No Fiscal Com.: Yes
Local: No

According to the State Board of Equalization, this bill affects the allocation, rather than the imposition, of tax and so it has no revenue impact.

Local governments which own airports or have airports located within their borders will gain revenue as a result of this bill. Local governments which are the site of negotiations for fuel contracts will lose revenues. Local governments' share of tax from the sale of jet fuel is about \$9.4 million annually.

State sales taxes are unaffected.

SUPPORT : (Verified 7/14/98)

Cities of San Jose, Lancaster, Los Angeles
Counties of Orange, San Bernardino, Sacramento, San Diego
State Board of Equalization
Burbank Chamber of Commerce
Aris Helicopters, Ltd.
Corporate Aircraft, Inc.

OPPOSITION : (Verified 7/14/98)

Contra Costa County
City of Laguna Hills
Contra Costa County Sheriff

ARGUMENTS IN SUPPORT : According to the Senate Revenue and Taxation Committee analysis, this bill is intended to allocate sales tax to those local jurisdictions which own airports or which have airports located within their borders. Proponents argue that these localities must bear the costs associated with aircraft landing and arriving in their jurisdictions and therefore they should receive the tax revenues aircraft generate when they refuel.

Orange County states, "Existing practice typically sends jet fuel sales tax to the communities that negotiate the sales. These communities are required to spend very little of their resources to accommodate the transactions. Con-versely, the municipalities that either run or house airports must ameliorate increased traffic, air pollution and other associated impacts. Aircraft allocation is the most logical, as airport localities bear the most significant costs."

ARGUMENTS IN OPPOSITION : In Contra Costa County, Chevron Corporation maintains offices in Walnut Creek where it negotiates sales of jet fuel. If AB 66 were to be enacted, it would mean a loss of over \$2 million in sales tax revenues to that city. In turn, this would translate into a direct loss of at least \$50,000 per year for the county. More significantly though, the bill would also result in the loss of Proposition 172 funding which is used to support public safety activities throughout the county. Proposition 172 sales tax generated revenues are based on the proportionate share of all sales tax raised in the county to the total sales tax raised statewide. Since the loss of the \$2 million from Walnut Creek would go to other counties, Contra Costa would be a net loser. Contra Costa estimates this loss at about \$1.4 million in public safety funds annually. _

ASSEMBLY FLOOR :

AYES: Ackerman, Aguiar, Alby, Alquist, Aroner, Baca, Baldwin, Bordonaro, Bowen, Bowler, Brown, Campbell,

Cardenas, Cardoza, Cedillo, Cunneen, Davis, Ducheny,
Escutia, Figueroa, Firestone, Frusetta, Gallegos,
Goldsmith, Granlund, Havice, Hertzberg, Honda, House,
Kaloogian, Keeley, Knox, Kuehl, Kuykendall, Lempert,

Leonard, Machado, Martinez, Mazzone, McClintock, Migden,
Miller, Morrissey, Murray, Napolitano, Olberg, Oller,
Ortiz, Papan, Perata, Poochigian, Prenter, Scott,
Shelley, Strom-Martin, Sweeney, Takasugi, Thomson,
Torlakson, Villaraigosa, Vincent, Washington, Wayne,
Wildman, Woods, Wright, Bustamante
NOES: Ashburn, Baugh, Brewer, Leach, Morrow, Pacheco,
Runner, Thompson
NOT VOTING: Battin, Floyd, Margett, Pringle, Richter

DLW:ctl 7/15/98 Senate Floor Analyses
SUPPORT/OPOSITION: SEE ABOVE
**** END ****

1 THOMAS F. CASEY III, COUNTY COUNSEL (SBN 47562)
 By: David A. Silberman, Deputy (SBN 211708)
 2 Hall of Justice and Records
 400 County Center, 6th Floor
 3 Redwood City, CA 94063
 Telephone: (650) 363-4749
 4 Fax: (650) 363-4034

5 Attorneys for Petitioner
 COUNTY OF SAN MATEO

8 BEFORE THE CALIFORNIA
 9 STATE BOARD OF EQUALIZATION

10
 11 COUNTY OF SAN MATEO

12 Petitioner,

13 vs.

14 CALIFORNIA STATE BOARD OF
 EQUALIZATION

15 Respondent.
 16

**PETITION TO AMEND OR REPEAL
 BOARD OF EQUALIZATION
 REGULATION 1699(H)**

(CAL GOV'T CODE §§ 11340.6, 11340.7)

1 I. INTRODUCTION

2 The County of San Mateo is host to one of the busiest airports in the Country. San Francisco
3 International Airport ("SFO") is located entirely within an unincorporated area of San Mateo County.
4 Due to its sheer size and the intensity of its operations, SFO impacts the citizens of the County of San
5 Mateo in many ways, including increased traffic, noise and other environmental impacts. Because SFO
6 is owned and operated by the City and County of San Francisco, the County of San Mateo has little
7 authority to directly regulate the airport. As a result, the County depends on the collection of sales tax
8 revenue to at least partially offset the impacts caused locally by SFO.

9 San Mateo County has recently learned that United Airlines, one of SFO's primary carriers, has
10 engaged in an elaborate scheme to pilfer these sales tax dollars at a time when local resources are already
11 strained. Unfortunately a new Board of Equalization (the "Board") regulation, Regulation 1699(h), may
12 allow the scheme. Because we believe the Board will agree that the scheme is inappropriate, the County
13 of San Mateo respectfully requests that either the Board instruct its staff to interpret Regulation 1699(h)
14 in a way that prevents this type of scheme or, alternatively, amend Regulation 1699(h).

15 II. STATEMENT OF FACTS

16 Back in the Summer and Fall of 2001 the Board sought public participation related to the
17 promulgation of a new regulation. The stated purpose for the new regulation was to clarify the standard
18 for Board recognition of subsidiaries that resell taxable goods to parent companies (or fellow
19 subsidiaries). See Exhibit A at 4.¹ The underlying issue is the requirement that, for collection of sales
20 tax purposes, the Board recognize actual retail sales between separate legal business entities but disregard
21 mere transfers of property between related business units for non-retail purposes. *Id.* The decision to
22 draft the new regulation was apparently influenced by Board difficulties in evaluating these business
23 relationships and the trend in certain sectors to create what are referred to as "Buying Companies"—
24 subsidiaries formed to serve the sole purpose of purchasing goods necessary in the business cycle and
25 then reselling the goods to the parent (or other subsidiaries). See Exhibit B at 2.

26
27 ¹ Exhibits A, B, C, D, E, F, J, M, N, O and P come from Board Of Equalization files. Exhibits G, H, I
28 and L come from City of Oakland files.

1 Local governments were very concerned about issuing Sales Permits to buying companies. The
2 concerns were expressed directly to the Board during the public comment period. For example, the
3 California State Association of Counties wrote:

4 CSAC is concerned over the relaxing of current standards to establish
5 "buying companies." We recognize that there may be legitimate purposes
6 for establishing a buying company; however, we believe that the current
7 more rigorous, standards are more appropriate for California businesses
8 and act as a safeguard against potential "gaming" of local sales tax
9 revenues. The proposed changes could open the door to establishment of
10 buying companies for the express purpose of receiving a sales tax rebate by
11 locating in a certain jurisdiction.² See Exhibit C.

12 Tax consultants, like KPMG, also provided public comment.³ See, e.g., Exhibits D & J. These
13 consultants downplayed the possibility of businesses forming buying companies for the sole improper
14 purpose of redirecting sales tax revenues to the highest bidder. See, e.g., Exhibit E at 4; Exhibit F at 6.
15 However, at the exact same time it was advocating before the Board, KPMG had been retained by United
16 Airlines for just this purpose—KPMG was directed in September 2001 to find a public entity that would
17 be willing to kick-back substantial sales taxes back to United Airlines in exchange for locating a fuel
18 buying company in the jurisdiction. See Exhibit G. KPMG initially approached public entities in
19 Southern California, but when it could not find an interested entity it moved north, contacting the City of
20 Oakland in the Spring of 2002. See Exhibits H & K.

21 Oakland and United Airlines eventually signed an agreement, by which United promised to form
22 a "buying company" and locate it in Oakland in exchange for Oakland's promise to pay United *sixty-five*
23 *percent* (65%) of all sales taxes it received from sales between the buying company and United. See
24 Exhibit I. Accordingly, United opened up a sales office of in Oakland. It was *easy* for United—it had
25 already formed a subsidiary, United Aviation Fuels, to consolidate purchases of jet fuel back in 1983.
26 See Exhibit G. As United itself explained in a newspaper article about the deal:

27 ² As will be discussed below, generally sales taxes are allocated to the jurisdiction where the retailer is
28 located. The BOE treats sales made by entities possessing Sales Permits as retail sales.

³ For example, KPMG proposed the following language for the new regulation, "[t]here is a strong
presumption that a business purpose exists, unless there is clear and convincing evidence that the sole
reason for creating the company was tax evasion." See Exhibit J.

1 "[t]he beauty of the arrangement, United spokesman Jeff Green said, is that
2 relocation of the subsidiary is essentially paperwork. The company would
3 open a one-person sales office at Oakland International Airport.... The
4 deal requires neither construction nor the transfer of a single drop of jet
5 fuel into or out of Oakland. The deal would just consolidate purchasing the
6 company does for the west coast, work that can be handled by one
7 additional employee.... Although United has major operations in both San
8 Francisco and Los Angeles, it is unlikely either city would offer the same
9 business incentives... Green said." See Exhibit K.

10 As Oakland stated: "City officials agreed to this deal because of the sheer volume of business and
11 potential for general fund revenue...the deal adds desperately needed dollars to the city coffers." *Id.* As
12 the agreement itself provides "without this Agreement, [United] would not cause the establishment of
13 this new operation in [Oakland] and would likely establish this new operation elsewhere." See Exhibit I
14 at 3.

15 Beginning in the First Quarter of 2004, tax revenues that were previously going to San Mateo
16 County, San Jose, San Francisco, Sacramento County, San Diego, the City of Los Angeles and other
17 public entities were all redirected to Oakland, primarily to the benefit of United Airlines.⁴

18 III. DISCUSSION

19 As noted above, on February 6, 2002 the Board approved an amendment to Board Regulation
20 1699, which governs issuance of sales permits, which are required of every entity that sells taxable
21 tangible personal property. Regulation 1699(h) governs when the Board will issue a sales permit to what
22 it terms "Buying Companies".⁵ In a nutshell, Regulation 1699(h) purports to ensure that buying
23 companies formed for the sole purpose of redirecting sales tax will not be issued sales permits.
24 Regulation 1699(h). However, Regulation 1699(h) has been interpreted by the Board to require issuance
25 of a sales permit whenever an applicant can show either that the buying company "[a]dds a markup to its

26 ⁴ AB 2466 was sent to the Governor on September 16, 2004 and vetoed by the Governor on September
27 30, 2004. The legislature recognized the inequality and bad policy inherent in allowing Oakland to take
28 tax revenues without bearing any additional burden. AB2466 would have ensured that, as the legislature
intended when it passed AB66 in 1998, sales tax revenues associated with the sales of jet fuel, would be
allocated to the public entities that are most affected by the airports.

⁵ The Board defines a "Buying Company" as "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." Regulation 1699(h).

1 cost of goods sold in an amount sufficient to cover its operating and overhead expenses” or that it
 2 “[i]ssues an invoice or otherwise accounts for the transaction.”

3 There is no dispute that businesses can use Regulation 1699(h) to redirect sales tax from one (or
 4 more) local jurisdictions to another local jurisdiction. The way United appears to have used it to “game”
 5 the system is as follows: under Revenue & Taxation Code Section 7205(b), sales of jet fuel are deemed
 6 to be consummated at the “point of the delivery of that jet fuel to the aircraft.” But, Section
 7 7205(b)(2)(B) provides that this rule applies where “the retailer has more than one place of business in
 8 the state.” Otherwise, it could be argued that Section 7205(a) would apply and sales would be deemed
 9 consummated at the retailer’s place of business. Based upon this language, United apparently concluded
 10 that if it could turn itself into the lone retailer, it could avoid the Legislature’s intent and “choose” the
 11 location where the sales tax would be allocated. See Exhibit L. Based upon its theory, it eventually
 12 approached Oakland and negotiated the aforementioned agreement, which provided that in exchange for
 13 a 65% rebate in tax, United would direct sales tax to it. *Id.* It implemented its plan by opening in
 14 Oakland a single-location business office of its longstanding subsidiary, United Aviation Fuels. It then
 15 applied for and received a Sales Permit from the Board of Equalization based upon its claim that this new
 16 business office was a “Buying Company” as defined by Regulation 1699(h). Finally, it cancelled the
 17 Sales Permits that had been previously issued for each airport with which United does business. Of
 18 course many variations of this scheme are possible. For example, a business could also redirect sales
 19 taxes from multiple vendors by forming a 1699(h) buying company because by forming the buying
 20 company the vendors would no longer be the retailer, the buying company would be.⁶

21
 22
 23
 24 ⁶ For example, Business A purchases numerous goods from numerous vendors, for example basic office
 25 supplies from Pencils R’Us, desktops from Computers R’Us and business furniture from Cubicles R’Us.
 26 If Pencils R’Us, Computer R’Us and Cubicles R’Us are in three separate local jurisdictions, then three
 27 separate public entities receive sales tax under Revenue & Taxation Code Section 7205 and Regulation
 28 1802 because, again, generally sales are deemed consummated at the retailer’s place of business. But if
 Business A obtains a Sales Permit for a business office, it can redirect the sales tax to a different
 jurisdiction or jurisdictions by purchasing the goods from the three vendors and reselling the product at
 cost to itself.

1 A. Regulation 1699(h) Is Being Interpreted In A Manner Inconsistent With The Bradley
2 Burns Act As It Allows Recognition Of Business Entities Formed For The Sole Purpose
3 Of Redirecting Tax

4 The Board must repeal or amend Regulation 1699(h) to the extent that it forces Board Staff to
5 recognize buying companies formed for the sole purpose of redirecting tax.

6 The Board itself, in promulgating Regulation 1699(h), appeared to acknowledge that a Regulation
7 that allowed recognition of an entity formed solely for the purposes of redirecting sales tax would run
8 afoul of the Bradley-Burns Bill of Rights. This awareness is established by the language of the
9 Regulation, which provides:

10 A buying company formed, however, for the sole purpose of purchasing
11 tangible personal property ex-tax for resale to the entity which owns or
12 controls it or to which it is otherwise related in order to re-direct local sales
13 tax from the location(s) of the vendor(s) to the location of the buying
14 company shall not be recognized as a separate legal entity from the related
15 company on whose behalf it acts for purposes of issuing it a seller's permit.
16 Such a buying company shall not be issued a seller's permit.

17 As Board Staff has repeatedly explained:

18 "[t]he shifting of local tax from one jurisdiction to another does not result
19 in retailers paying any additional tax. Therefore, any additional revenue
20 derived by one city will be at the expense of others. The Board is
21 statutorily and contractually obligated to ensure that the cities in which
22 sales occur receive the local tax revenues and to discourage activities
23 designed to divert local tax from one city to another.

24 See Exhibit M at 4; see also Rev. & Tax. Code § 7224 ("Each local jurisdiction has the right to have the
25 law administered in a uniform manner"). Similarly, allowing tax-redirection schemes would violate the
26 Board's statutory duty to businesses. As Board Staff has explained "[t]he Bradley-Burns law also
27 afforded merchants protection from untaxed [and under-taxed] competitors located in nearby cities." See
28 Exhibit A at 2.⁷ Use of buying companies to redirect tax is also inconsistent with the Legislature's intent
in enacting Revenue and Taxation Code Section 7051.1. As Board Staff has explained:

⁷ Board Staff has explained that "[s]tarting in 1945, cities began levying sales and use taxes upon
retailers independent of those imposed by the State of California... . Businesses that operated within
cities that did not impose additional sales and use taxes were viewed as having an unfair competitive
advantage over those that did.... [T]he Bradley-Burns Uniform Local Sales and Use Tax Law was
enacted during the 1955 legislative session...[in part]...in response to [this] concern[]." See Exhibit A at
1.

1 Revenue and Taxation Code section 7051.1 gives the Board the statutory
 2 authority to allow a person, with prior approval by the Board, to purchase
 3 tangible personal property with a "direct payment permit" and to self report
 4 the sales tax. However, the statute specifically requires that the person
 5 allocate the local sales and use tax and any applicable district transactions
 6 and use tax to the municipality to which it would have been allocated if it
 7 had been reported and remitted by the retailers from whom the person
 8 purchased the property. Staff is of the opinion that a buying company is
 9 established to obtain many benefits that may be derived by use of a direct
 10 payment permit. The issuance of a direct payment permit is statutorily
 11 contingent upon the purchaser allocating the local and district taxes to the
 12 municipality that would have been the benefactor of those funds had the
 13 tax been collected and remitted by the retailer.

14 See Exhibit N at 6.

15 It would appear that the Board may have concluded that Regulation 1699(h) protected against
 16 creation of buying companies for the sole purpose of sales tax redirection by requiring that the Buying
 17 Company "otherwise account[] for the transaction". Regulation 1699(h). This requirement is no
 18 requirement at all. Practically, Regulation 1699(h) would require recognition of an unincorporated
 19 "business office" at a hypothetical company's office supplies warehouse that merely contains a computer
 20 that records arrival and departure of goods as they pass through the warehouse. The business office
 21 would not even need an employee if the arrival and departure of the office supplies were complete
 22 automated. As United stated setting up such an office is easy, it "is essentially paperwork."⁸ See Exhibit
 23 K. Because it is so easy to set up the buying company under the accounting prong, and the financial
 24 incentive is so large (millions of dollars a year to United, here), the "accounting" requirement provides
 25 no protection for public entities.⁹

26 ⁸ As Board Staff recognized, the "otherwise accounts" provision was not sufficient to ensure that the
 27 company is not created solely for the purpose of redirecting tax because it "[d]oes not require that an
 28 adequate audit trail be maintained [and] creates ambiguity with respect to what constitutes accounting for
 a transaction." See Exhibit N at 16.

⁹ The County recognizes that the "otherwise accounts" prong is only one of the two specified ways
 Regulation 1699(h) provides for demonstrating a business purpose. The County focuses on the
 "otherwise accounts" prong because, based on its discussions with Board Staff, it appears this prong was
 the basis for granting United's Oakland business office a sales permit. More important, even if the
 second prong, the "adds a markup" prong, were sufficient to discourage creation of buying companies for
 redirection, Regulation 1699(h) would still be invalid because Regulation 1699(h) requires a showing of
 only one of the two prongs.

1 State Board of Equalization staff recognized that the regulation would be invalid unless it
 2 included some sort of concrete requirement that the Buying Company be a separate legal entity.
 3 Accordingly, it suggested language that required that the Buying Company: "Maintain a separate identity
 4 with respect to the use of employees, accounting systems (including accounting for cash receipts and
 5 disbursements), facilities, and equipment." See Exhibit O; Exhibit M at 9; Exhibit N at 10. Staff further
 6 concluded that deleting this section would mean the regulation would fail to "provide meaningful
 7 requirements to deter the redirection of local tax [because it would] [a]llows permits to be issued to
 8 entities that are separate in name only." See Exhibit N at 18.

9 The lack of protection afforded by Regulation 1699(h) is exemplified by the tax-redirection
 10 scheme that provoked this Petition and the concurrently submitted Claim for Incorrect Distribution of
 11 Local Tax. It is clear that United Airlines formed a business office in Oakland for the sole purpose of
 12 obtaining a kick-back of sales tax dollars. United Airlines is a sophisticated multi-billion dollar multi-
 13 national corporation. United Airlines formed its fuel-buying subsidiary United Aviation Fuels more than
 14 20 years ago. Had there been a benefit to creating a business office for this subsidiary (other than that
 15 obtainable through the redirection of tax), United Airlines would have done so years ago. Even assuming
 16 that United did not discover the usefulness of buying companies until September 2001 when it retained
 17 KPMG, had there been any legitimate business reasons to set up a sales office, United would have set
 18 one up shortly after Regulation 1699(h) was promulgated. It could have easily done so while it
 19 continued to look for a public entity willing to provide it sufficient kickbacks. As United stated to the
 20

21 (continued ...)

22 However, the "adds a markup" requirement is also insufficient to ensure that company is not created
 23 solely for diverting tax because, as was explained to the Board while it was considering the regulation:
 24 "the markup proposed by staff [] is not a meaningful requirement for validating that the entity has an
 25 actual business purpose, since a markup on an inter company transaction does not represent profit, as the
 26 ultimate ownership is the same." See Exhibit N at 8. It is of note that, Board Staff's only substantive
 27 response to this concern was that "The requirement that a buying company achieve business advantages
 28 sufficient to cover the costs of creating and operating the entity is irrelevant as it can be reasonably
 assumed that an entity will not form a buying company unless such advantages can be derived." *Id.* This
 assumption is simply wrong. The company can "derive a benefit" regardless whether creating the
 business entity provides direct economic benefits—as the events underlying this petition demonstrate, a
 company can obtain an indirect benefit in the form of a kick-back negotiated in exchange for the
 redirection of sales tax.

1 press “[t]he beauty of the arrangement...is that relocation of the subsidiary is essentially paperwork. The
 2 company would open a one-person sales office at Oakland International Airport...the deal requires
 3 neither construction nor the transfer of a single drop of jet fuel into or out of Oakland.” See Exhibit K.
 4 Instead United apparently did not set up the office until almost three years after it began searching for a
 5 partner. In addition, in negotiating the deal with Oakland, United admitted that Oakland was, at best, its
 6 second choice for locating the sales office, indicating that the only benefit it would obtain by creation of
 7 the office was the kick-back it would receive from Oakland. As United explained to the press, it picked
 8 Oakland solely because it “would offer the [largest] business incentives.” *Id.* These facts make clear
 9 that the only economic benefit that United would receive from its scheme is the share of public funds it
 10 was receiving from Oakland in the form of the tax rebate.

11 Because Regulation 1699(h) does not prevent entities like United from siphoning away public
 12 dollars through creation of businesses offices with no permissible business purposes, it is invalid. *Dyna-*
 13 *Med, Inc. v. Fair Employment & Housing Comm’n*, 43 Cal.3d 1379, 1389 (1987) (“Administrative
 14 regulations that alter or amend the authorizing statute or enlarge or impair its scope are void and courts
 15 not only may, but it is their obligation to strike down such regulations.”).¹⁰

16 B. Regulation 1699(h) Is Inconsistent With State Law In That It Allows Recognition Of
 17 Business Units and Subsidiaries That Have No Separate Legal Identity

18 Regulation 1699(h) is also invalid to the extent that it is interpreted to allow the Board to
 19 recognize corporate sub-units that lack identity separate from the parent. *Mapo v. State Board of*
 20 *Equalization*, 53 Cal. App. 3d 245 (1976).

21
 22
 23 ¹⁰ Allowing redirection of tax from San Francisco and San Mateo also runs afoul of the “Public Purposes
 24 Doctrine.” Many jurisdictions have held that a public entity cannot be required to turn over a portion of
 25 its tax revenues to another political subdivision without receiving some substantial benefit in return.
 26 These jurisdictions have reasoned that redirection of taxes results in an impermissible lack of
 27 uniformity—the same uniformity that Bradley-Burns seeks to foster. See *Sigma Tau Gamma Fraternity*
 28 *House Corp. v. City of Menomonie*, 288 N.W. 2d 85, 94 (Wis. 1980); *Tennant v. Sinclair Oil & Gas Co.*,
 355 P.2d 887, 889 (Wyo. 1960); *City of Dallas v. Love*, 23 S.W. 2d 431, 433 (Tex. Civ. App. 1930);
State v. Board of Commissioners of Douglas County, 189 N.W. 639, 642 (Neb. 1922); *Campbell County*
v. City of Newport, 193 S.W. 1, 6 (Ky. Ct. App. 1917); *Commissioners of Johnston County v. Lacy*, 93
 S.E. 482, 484 (N.C. 1917); *Beach v. Bradstreet*, 82 A. 1030, 1034-35 (Conn. 1912).

1 In *Mapo*, the Board contended that Mapo, an incorporated wholly-owned subsidiary of a wholly-
2 owned subsidiary of Walt Disney Productions was required to pay sales tax on sales made to Walt
3 Disney Productions. *Id.* at 247. Mapo was paid by Walt Disney Productions at a rate of two times
4 Mapo's labor cost for fabricating the goods sold. *Id.* at 248. The sales made by Mapo to Walt Disney
5 Productions were tracked. *Id.* The Court held that the sales between Mapo and Walt Disney Productions
6 were not retail sales subject to sales tax. *Id.* at 249. It reasoned that the Board of Equalization is required
7 to ignore business units for tax purposes where they do not maintain a separate identity. *Id.*

8 Regulation 1699(h) is directly inconsistent with *Mapo* because it limits Board Staff's inquiry to
9 the way that the buying company transacts its business and does not allow Board Staff to address the
10 structural "separate identity" issue critical to the Court in *Mapo*. The fact that a "buying company" may
11 "add a markup to its costs of goods" or "accounts for [its] transaction[s]" with its corporate relatives does
12 not mean that it has a separate identity from them. This was true of Mapo, as it both added a markup to
13 the cost of its goods and accounted for its transactions.

14 Board Staff appears to agree with this interpretation, opining:

15 However, in contrast to Deloitte's position, the courts have declared that
16 when two separate legal entities have such identity of interest as to be
17 separate in name only, the Board must regard them as one entity and
18 disregard sales made between each other. In addition, staff believes that a
19 buying company should be recognized as a separate legal entity when it is
formed for a valid business purpose and it actually engages in business and
maintains adequate books and records with respect to its transactions. Staff
is of the opinion that these two elements are interdependent and not
mutually exclusive."

20 See Exhibit N at 7; see also *Touche Ross & Co. v. State Board of Equalization*, 203 Cal. App. 3d 1057,
21 1067 (1988) ("The mere fact that a corporate entity is subdivided into unincorporated departments or
22 divisions does not transform those departments or divisions into separate legal entities for tax purposes").

23 C. Even If Generally Valid, Regulation 1699(h) Cannot Be Applied To Sales Of Jet Fuel At
24 San Francisco International Airport

25 Even if it is not invalid generally, Regulation 1699(h) should be amended to make clear that it
26 cannot apply to jet fuel sales to United at SFO. By passing Revenue and Taxation Code Section 7204.03,
27 the Legislature made clear that it intended that San Mateo County and San Francisco split all sales taxes
28 collected on jet fuel sales at SFO. While it may be true that Section 7204.03 is limited to sales of jet fuel

1 by retailers with more than one place of business in the state, at the time Section 7204.03 was enacted in
 2 1998, the Board was still requiring that a buying company demonstrate separate legal identity before
 3 issuance of a sales permit. *See, e.g., Exhibit P.* By promulgating Regulation 1699(h) the Board
 4 inadvertently created the very mechanism that has allowed United to circumvent the Legislature's intent.
 5 As interpreted, Regulation 1699(h) will result in no jet fuel taxes being directed to San Francisco and San
 6 Mateo.

7 In addition, to the extent that Regulation 1699(h) is interpreted to allow redirection of jet fuel
 8 taxes, it is preempted by the Anti-Head Tax Act ("AHTA"). *See, generally, Rim of the World Unified*
 9 *School District v. Superior Court*, 104 Cal. App. 4th 1393, 1398-99 (2002) ("State law is preempted to
 10 the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state
 11 and federal law, or where the state law stands as an obstacle to the accomplishment of the full purposes
 12 and objectives of Congress."). The AHTA prescribes the types of local and state taxes that may be
 13 imposed on air travel. 49 U.S.C. § 40116. While the AHTA does not prohibit taxes on jet fuel, (49
 14 U.S.C. § 40116(e)), it does limit the entities that can impose them: "[a] State or political subdivision of a
 15 State may levy or collect a tax on or related to a flight of a commercial aircraft or an activity or service
 16 on the aircraft only if the aircraft takes off or lands in the State or political subdivision as part of the
 17 flight." 49 U.S.C. § 40116(c). Accordingly, only San Mateo County and the State of California can levy
 18 taxes on jet fuel sold to airlines for flights out of San Francisco International. Any other taxes on this
 19 fuel are invalid.

20
21 Dated: December 30, 2004

Respectfully submitted,

THOMAS F. CASEY III, COUNTY COUNSEL

22
23
24 By: David Silberman
 25 David A. Silberman, Deputy

26 Attorneys for Petitioner
27 COUNTY OF SAN MATEO

CALIFORNIA CODES
GOVERNMENT CODE SECTIONS 11340.6 and 11340.7

11340.6. Except where the right to petition for adoption of a regulation is restricted by statute to a designated group or where the form of procedure for such a petition is otherwise prescribed by statute, any interested person may petition a state agency requesting the adoption, amendment, or repeal of a regulation as provided in Article 5 (commencing with Section 11346). This petition shall state the following clearly and concisely:

- (a) The substance or nature of the regulation, amendment, or repeal requested.
- (b) The reason for the request.
- (c) Reference to the authority of the state agency to take the action requested.

11340.7. (a) Upon receipt of a petition requesting the adoption, amendment, or repeal of a regulation pursuant to Article 5 (commencing with Section 11346), a state agency shall notify the petitioner in writing of the receipt and shall within 30 days deny the petition indicating why the agency has reached its decision on the merits of the petition in writing or schedule the matter for public hearing in accordance with the notice and hearing requirements of that article.

(b) A state agency may grant or deny the petition in part, and may grant any other relief or take any other action as it may determine to be warranted by the petition and shall notify the petitioner in writing of this action.

(c) Any interested person may request a reconsideration of any part or all of a decision of any agency on any petition submitted. The request shall be submitted in accordance with Section 11340.6 and include the reason or reasons why an agency should reconsider its previous decision no later than 60 days after the date of the decision involved. The agency's reconsideration of any matter relating to a petition shall be subject to subdivision (a).

(d) Any decision of a state agency denying in whole or in part or granting in whole or in part a petition requesting the adoption, amendment, or repeal of a regulation pursuant to Article 5 (commencing with Section 11346) shall be in writing and shall be transmitted to the Office of Administrative Law for publication in the California Regulatory Notice Register at the earliest practicable date. The decision shall identify the agency, the party submitting the petition, the provisions of the California Code of Regulations requested to be affected, reference to authority to take the action requested, the reasons supporting the agency determination, an agency contact person, and the right of interested persons to obtain a copy of the petition from the agency.

State of California
BOARD OF EQUALIZATION

SALES AND USE TAX REGULATIONS

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.

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.

Regulation 1699. (Continued)

- 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

Regulation 1699. (Continued)

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.

Regulation 1699. (Continued)

History: Effective July 1, 1939.
Adopted as of January 1, 1945, as a restatement of previous rulings.
Amended August 2, 1965, applicable on and after August 1, 1965.
Amended and renumbered November 3, 1969, effective December 5, 1969.
Amended May 25, 1977, effective June 24, 1977.
Amended May 1, 1985, effective May 31, 1985. Subdivision (e)(2) has been changed to provide that penalties for intent to evade the tax are excluded from the type of penalty the permit holder would be liable for if the permit holder fails to notify the Board of the transfer of a business.
Amended June 22, 1995, effective July 22, 1995. Amended subdivision (e) as provided in Statutes of 1993, Chapter 1109.
Amended April 25, 1996, effective May 25, 1996. Added new (c) to incorporate provisions of Chapter 696, Statutes of 1995 and renumbered the following subdivisions.
Amended May 30, 2001, effective September 7, 2001. Subdivision (d)—Existing language deleted—Four new unnumbered paragraphs added to define “concessionaire” and clarify the relationship between concessionaire and prime retailer. New Appendix A was added to provide a suggested form for the Certification of Permit—Concessionaire.
Amended February 6, 2002, effective June 14, 2002. Subdivisions (h) and (i) added.

Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.

Appendix A

Certification of Permit – Concessionaires

I certify that I operate an independent business at the premises of the following retailer and that I hold a valid seller's permit to operate at this location, as noted below. I further understand that I will be solely responsible for reporting all sales that I make on those premises and remitting all applicable sales and use taxes due to the Board of Equalization:

Name of retailer on whose premises I operate my business: _____

Location of premises: _____

I hereby certify that the foregoing information is accurate and true to the best of my knowledge:

Certifier's Signature: _____ Date _____

Certifier's Printed Name _____

Certifier's Seller's Permit Number _____

Certifier's Business Name and Address* _____

Certifier's Telephone Number _____

*** Please Note:** The certifier *must* be registered to do business at the location of the retailer upon whose premises he or she is making retail sales.