



1 (2) The Board could inform staff of its tentative determination and direct staff to prepare  
2 a proposed Summary Decision (or Memorandum Opinion) that reflects the tentative  
3 determination for Board approval as soon as practicable. Under this option, the Board  
4 would hold any determination of the appeal in abeyance until it has the opportunity to  
5 consider the proposed decision. The Board's later vote to adopt the decision would also  
6 constitute its vote to resolve the appeal, and within 45 days a notice of determination  
7 would be mailed. The 30-day PFR period would begin on the date the notice is mailed.  
8 If no PFR is filed, the Summary Decision (or Memorandum Opinion) would then be  
9 timely posted on the Board's website pursuant to section 40.

10 We also note a request could be made during the oral hearing that the Board take Option 2  
11 above and defer its vote to determine the appeal until it adopts a Summary Decision (or Memorandum  
12 Opinion). On the other hand, it may be preferred that the Board follow its usual practice in business  
13 tax appeals, which typically would result in a vote to resolve the appeal on the day of the hearing, thus  
14 accelerating the resolution process, but potentially requiring a PFR to be filed before the content of the  
15 Summary Decision (or Memorandum Opinion) is adopted by the Board.

16 This appeal was scheduled for Board hearing on August 13, 2013, but was postponed at  
17 Ontario's request because its representative needed more time to assemble documentation for its  
18 opening brief.

19 Taxpayer is a wholly owned subsidiary of a company (parent) that sells medical and health care  
20 products. Taxpayer's corporate headquarters is located outside California, but opened an office in  
21 Ontario on August 1, 2005, after it had entered into a 20-year Location Agreement effective August 1,  
22 2005, which required it to do so. Under that agreement, when Ontario receives local sales tax from  
23 taxpayer, it must pay taxpayer up to 50 percent of such tax and Ontario retains the difference. The  
24 sales at issue were shipped from inventory located at California warehouses in Fontana (now San  
25 Bernardino) and Lathrop that were owned and operated by taxpayer's parent and thus the sales  
26 occurred (title passed) inside California. Beginning August 1, 2005, taxpayer reported local tax on  
27 these sales (as opposed to parent prior to August 1, 2005) as sales tax and allocated that tax to Ontario,  
28 thereby gaining the right to a tax rebate of up to 50 percent of such tax (if the allocation is upheld),  
29 based on the view that the sales were principally negotiated at the Ontario office which was thus the  
30 place of sale.

1 The petitions received on November 9, 2006 were filed by Fontana and Lathrop and the  
 2 petition received on May 4, 2009 was filed by San Bernardino.<sup>2</sup> Fontana, Lathrop and San Bernardino  
 3 (petitioners) seek reallocation to them of the local tax that was allocated to Ontario. While the Sales  
 4 and Use Tax Department (Department) initially denied the petitions, it later granted the petitions and  
 5 on July 29, 2010, notified Ontario that it would be substantially affected. Ontario timely appealed, and  
 6 we issued our Decision and Recommendation (D&R) recommending that the petitions be granted.

### 7 UNRESOLVED ISSUE

8 Whether the local tax was incorrectly allocated as sales tax to the office located in Ontario. We  
 9 conclude that the local tax was sales tax which was incorrectly allocated to Ontario and should be  
 10 reallocated to the location of the warehouse making the delivery.

11 Ontario contends that the sales are subject to sales tax under California Code of Regulations,  
 12 title 18, section (Regulation) 1620, subdivision (a)(2)(A) because the sales occurred in California, the  
 13 Ontario office is a place of business of taxpayer (i.e., taxpayer had a lease in its name for that office;  
 14 had five employees working in that office (inside sales staff<sup>3</sup>); had about 69 employees assigned to  
 15 work out of that office (outside sales staff<sup>4</sup>); stored product returns, samples and literature at that  
 16 office; and trained staff at that office), and that office participated in the sales (i.e., Ontario asserts that:  
 17 outside sales staff used this office to contact and meet with customers, organize sales presentations,  
 18 negotiate sales terms, take orders, and meet with staff; and inside sales staff used this office to receive,  
 19 review, and approve orders for release to a California warehouse for delivery, assist outside sales staff  
 20 in setting up new accounts and managing customer concerns, and handle credit applications). Ontario  
 21 notes that, under Regulation 1802, subdivision (a)(2)(B), sales participation includes credit approval  
 22 and order acceptance or approval, and the place of principal negotiations is where an employee's  
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24 <sup>2</sup> On November 21, 2007, the Sales and Use Tax Department operationally documented a date of knowledge for San  
 25 Bernardino that is earlier than the date its petition was received. This means that for San Bernardino, the date of knowledge  
 is November 21, 2007, and that is the date used to calculate the amount in dispute.

26 <sup>3</sup> The term "inside sales staff" is shorthand for referring to a person assigned the title of account service representative,  
 dedicated service representative, or procurement processing specialist, that is employed by taxpayer and who works in  
 taxpayer's Ontario office.

27 <sup>4</sup> The term "outside sales staff" is shorthand for referring to a person assigned the title of sales representative, account  
 representative, sales associate, account manager, or territory manager, that is employed by taxpayer and who works  
 28 primarily in the field or out of their homes located in California.

1 activities are attributed. Ontario argues that outside sales staff negotiated the Supply Agreements and  
2 thus, at a minimum, participated in the sales made pursuant to such agreements. It further argues that  
3 inside sales staff participated in all California sales by virtue of their review-to-release activities.  
4 Ontario asserts that outside sales staff were neither assigned to the out-of-state headquarters nor  
5 worked with parent's staff located outside California, and inside sales staff performed sales activities  
6 rather than merely administrative activities, which are performed by parent under an Administrative  
7 Services Agreement.

8 Ontario contends that the local tax cannot be allocated to the locations of the California  
9 warehouses because they are not taxpayer's places of business (i.e., taxpayer does not own, lease,  
10 operate, or maintain inventory at the California warehouses, and outside sales staff do not use, and  
11 customers do not visit, these warehouses). It further contends that the Ontario office was entitled to  
12 hold a seller's permit under Regulation 1699, subdivision (a) because that is where contract  
13 negotiations by outside sales staff are attributed, and that is where inside sales staff receive orders.  
14 Ontario also contends that parent buys goods from its subsidiary for resale to taxpayer which taxpayer  
15 sells to its California customers.

16 Ontario concludes that the sales were properly allocated to taxpayer's Ontario office under  
17 Regulation 1802, subdivision (a)(1) and thus no reallocation is warranted. Furthermore, Ontario notes  
18 that, even if reallocation were permissible, under section 7209, the Board is not required to make a  
19 reallocation and asserts that reasons exist here for the Board to consider not making a reallocation (i.e.,  
20 the Department's field auditor advised taxpayer to report all but 1.3 percent of its sales to Ontario, the  
21 Department initially denied the petitions based on its determination that the Ontario office was a sales  
22 office, and millions of dollars have already been spent by Ontario).

23 Petitioners contend that, for the periods at issue, outside sales staff were still assigned to the  
24 out-of-state headquarters location and this is where sales negotiated by them should be attributed.  
25 They assert that the evidence does not show that outside sales staff were assigned to work out of the  
26 Ontario office. Petitioners argue that taxpayer's unsubstantiated claim of reassignment of its outside  
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1 sales staff to the Ontario office has been contradicted by employees of taxpayer and parent who were  
2 unaware that the Ontario office existed. They further argue that outside sales staff are not conducting  
3 sales negotiations at the Ontario office, they are still home based and work in the field just as they were  
4 when assigned to the out-of-state location, and inside sales staff only provide support to outside sales  
5 staff for some but not all California accounts.

6 Petitioners contend that taxpayer was not the retailer and seller of goods to the California  
7 customers. They assert that the evidence does not show that taxpayer purchased any goods for resale  
8 to California customers; rather, the evidence provided shows parent as the purchaser of such goods and  
9 that taxpayer acts as an independent contractor when providing sales order approval services to parent.  
10 Petitioners argue that taxpayer's Ontario office is thus not entitled to hold a seller's permit. They  
11 conclude that the local tax should be reallocated to the location of the warehouse making the delivery  
12 under Regulation 1802, subdivision (c).

13 The Department contends that the Ontario location is not a sales office, the sales are negotiated  
14 out of state, the warehouse locations are where taxpayer holds a stock of goods, and each warehouse  
15 location should hold a seller's permit under Regulation 1699, subdivision (a). It asserts that the  
16 evidence does not show that outside sales staff were assigned to work out of the Ontario office or that  
17 they negotiated sales at such location. The Department also asserts that the inside sales staff perform  
18 only administrative activities and do not supervise outside sales staff who report to out-of-state  
19 managers. It argues that since the outside sales staff perform sales activities from their homes or at the  
20 customers' locations, they are not working out of the Ontario office. The Department further argues  
21 that the Ontario location is not a place of business that requires registration since it is not a place where  
22 sales are customarily negotiated with its customer. It concludes that the local tax should be reallocated  
23 to petitioners under Regulation 1802, subdivision (c).

24 The initial issue in resolving this dispute is to determine who made the subject retail sales to  
25 California customers: parent, its subsidiary, or taxpayer. Only when we have identified that person can  
26 we determine the correct allocation of the local tax. Here, while parent claimed that taxpayer  
27 purchased the goods for resale pursuant to a verbal agreement under which parent or its subsidiary sold  
28 goods to taxpayer, we cannot accept a bare statement by parent or taxpayer, neither of whom is a

1 disinterested party. Instead, we believe the evidence provided shows that title to the goods passed  
2 from suppliers to parent and then from parent directly to the California customer. That is, invoices  
3 from suppliers show parent (not taxpayer) as the purchaser; purchase orders from customers are issued  
4 to parent (not taxpayer); and invoices to customers are prepared by parent showing itself as the seller  
5 (not taxpayer) with the place for making a remittance to a location of parent (not taxpayer). This is  
6 consistent with the terms of the Third Party Purchasing and Sales Approval Agreement which shows  
7 taxpayer approves parent's sales, not its own,<sup>5</sup> and with the Corporate Program Agreements between  
8 parent and California customers. Accordingly, we find parent is the retailer of the subject sales. (Rev.  
9 & Tax. Code, § 6015.)

10 This brings us to the question of the correct allocation of the local tax. A sale is subject to sales  
11 tax only if that sale occurs (title passes) in California and there is some participation in the sale by a  
12 California location of the retailer. (Cal. Code Regs., tit. 18, § 1620, subd. (a)(2)(A).) Where either or  
13 both of these conditions are not satisfied, the applicable tax is use tax. The same rules are applicable to  
14 determine whether the local tax is sales tax or use tax. (Rev. & Tax. Code, §§ 7202, 7303; Cal. Code  
15 Regs., tit. 18, § 1803.) Here, without regard to the Ontario office, the sales were clearly subject to state  
16 and local sales tax because the sales occurred in California with participation by a California  
17 warehouse of parent. As such, the disputed local tax must be allocated to the place of sale. (Rev. &  
18 Tax. Code, § 7205; Cal. Code Regs., tit. 18, § 1802, subd. (d) (this is generally a direct allocation if the  
19 location is required to hold a seller's permit under Regulation 1699).)

20 When a retailer has more than one California location, we look to the Board's rules set forth in  
21 Regulation 1802, subdivision (a)(2).<sup>6</sup> (Rev. & Tax. Code, § 7205, subd. (b)(1).) Since the California  
22 warehouses of parent from which delivery of the goods was made clearly participated in the sales, the  
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24 <sup>5</sup> Section 1.4 states: "[Taxpayer and subsidiary] will provide [parent] with order approval services for all of  
25 [parent's] sales to customers in Illinois, Texas and California. [Taxpayer and subsidiary] will use criteria provided  
26 by [parent] to review all sales orders from [parent's] customers in Illinois, Texas and California, and will advise  
27 [parent] which orders shall be approved and which orders should not be approved and require further follow-up. . . ."

28 <sup>6</sup> When only one California location of the retailer participates in the sale, the place of sale is at such location. (Cal. Code  
29 Regs., tit. 18, § 1802, subd. (a)(2)(A).) When more than one California location of the retailer participates in the sale, the  
30 place of sale is where the principal negotiations are conducted. (Cal. Code Regs., tit. 18, § 1802, subd. (a)(2)(B).) When  
the principal negotiations are conducted outside California, the place of sale is the California location of the retailer that  
most significantly participates in the sale.

1 local tax is allocated to the jurisdictions of those warehouses unless another business location of parent  
 2 participated in the sale, in which case further analysis is required. (Cal. Code Regs., tit. 18, § 1802,  
 3 subd. (a)(2)(A).) The only other possible California location of parent that could be regarded as having  
 4 participated in the sales is the Ontario location, but no one has claimed that location is a place of  
 5 business of parent or that any of parent's employees work in, at, or out of the Ontario office, nor would  
 6 the evidence support such claims. Rather, taxpayer leases the Ontario office in its own name on its  
 7 own account and not as agent for parent, and only taxpayer's employees are assigned to work in, at, or  
 8 out of that office. Accordingly, we find that the Ontario office is not a business location of parent for  
 9 purposes of section 7205 and Regulation 1802, meaning that none of the local tax at issue is properly  
 10 allocated to Ontario.

11 We conclude that since the California warehouse locations were the only in-state locations of  
 12 parent, parent is required to hold a seller's permit under Regulation 1699, subdivision (a) for each  
 13 warehouse location. Accordingly, the local sales tax for the subject sales should be reallocated to the  
 14 jurisdiction of the warehouse from which delivery was made under Regulation 1802, subdivision  
 15 (a)(2)(A). Even though the Board has the discretion under section 7209 to order no reallocation, we do  
 16 not find the facts here justify such a result and thus recommend that the petitions be granted.<sup>7</sup>

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 19 <sup>7</sup> For example, Ontario argues that since it relied on the Department's original position, the Board should order no  
 20 reallocation. There is absolutely nothing in the Board's regulations or rules that would prohibit the Department from  
 21 changing its mind during its review of a local tax allocation or an appeal regarding such allocation. Indeed, the Department  
 22 must change its position during the appeals process if it concludes its prior position is incorrect. That is the very reason that  
 23 the Department must review its own decision before the dispute is ripe for consideration by the Appeals Division.  
 24 Furthermore, if the Department were to fail to reverse its decision when it should have done so, it becomes the duty of the  
 25 Appeals Division to recommend a change to that position. (See, generally, Cal. Code Regs., tit. 18, § 1807.) Similarly, it is  
 26 the duty of the Appeals Division to change its recommendation if we conclude a prior recommendation is incorrect; and if  
 27 we fail to do so when we should have, it is the duty of the Board to reverse us. (*Ibid.*) Indeed, if the Board itself concludes  
 28 its decision is incorrect, it too must reverse itself. (See Cal. Code Regs., tit. 18, §§ 5561-5563.) That is, arguing that any  
 29 party cannot change its position during the administrative review process is a non-starter: the only issue is what is the  
 30 correct answer. Regarding Ontario's argument that it will suffer if reallocation is ordered because it has spent the money,  
 this is the situation in virtually every local tax reallocation dispute. It is our understanding that jurisdictions throughout  
 California have consistently supported the reallocation of local taxes to reflect the correct allocation of tax, knowing that  
 doing so could result in increases or decreases to their revenue, but always with the underlying goal of allocating the correct  
 amount of local tax to each jurisdiction. The risk of reallocation is known to all jurisdictions and they are entitled to the  
 amount of local tax properly due them for which they rely upon the Board to correctly collect and allocate or reallocate.  
 We note also that if we accepted this as a basis for rejecting an otherwise valid petition where Ontario received the initial  
 allocation, we would be duty bound to reject any otherwise valid petition by Ontario seeking a reallocation to its own  
 benefit.

**POST D&R MATTERS**

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2 Ontario filed an opening brief disputing our recommendation and attaching to that brief various  
3 declarations (exhibits A through G (some of which included attachments)) and a copy of the request  
4 for hearing (exhibit H). In that submission, Ontario repeatedly mischaracterizes the findings as stated  
5 in the D&R by the Appeals Division and incorrectly attributes those findings to the Department. It  
6 also asserts that the Appeals Division has the burden of proof on various issues (referring to “the  
7 Department” when clearly referring to the author of the D&R, that is, the Appeals Division). The  
8 Appeals Division has no burden “of proof” in this appeal. We have the burden of trying to reach the  
9 correct conclusions by applying the applicable law to the facts as we find them, a duty that includes  
10 applying the appropriate burden of proof rules among the parties, and explaining the reasons for our  
11 conclusions in the D&R.

12 The record establishes that the suppliers of the subject tangible personal property issued their  
13 invoices to parent, that the customers issued their purchase orders for that property to parent, that  
14 parent issued sales invoices for its sales of that property to its customers, and that the customers  
15 remitted their payments for that property to parent. That is, the evidence unequivocally establishes that  
16 parent made the subject sales, and not taxpayer. Since Ontario obviously cannot overcome this  
17 unequivocal evidence, its submission ignores it altogether, instead focusing on taxpayer’s intent. We  
18 accept that it is entirely possible parent created taxpayer with the intent of arranging matters so that  
19 taxpayer would be the seller in the subject sales. However, without regard to any such intent, the  
20 simple fact is that the subject sales were actually made by parent. None of the argument or supporting  
21 documentation in Ontario’s submission overrides this fact. Accordingly, we continue to recommend  
22 that the petitions be granted.

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24 Summary prepared by Trecia M. Nienow, Tax Counsel IV  
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