

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petitions for Reallocation of Local Tax Under the Uniform Local Sales)
and Use Tax Law of:)

CITIES OF AGOURA HILLS, ALAMEDA, ALBANY, BAKERSFIELD, BELMONT,)
BERKELEY, BEVERLY HILLS, BRISBANE, CALABASAS, CAMPBELL,)
CARLSBAD, CHULA VISTA, CLOVIS, COMPTON, CUPERTINO, DALY CITY,)
DAVIS, DELANO, DEL MAR, EAST PALO ALTO, EL CAJON,)
EL MONTE, EMERYVILLE, ESCONDIDO, FILLMORE, FOSTER CITY, FREMONT,)
FRESNO, GARDENA, GILROY, HALF MOON BAY, HAWTHORNE, HAYWARD,)
KERMAN, KINGSBURG, LOS ANGELES, MENLO PARK, MILPITAS, MORENO)
VALLEY, MORGAN HILL, PALMDALE, PALO ALTO, PASADENA, RANCHO)
CORDOVA, RANCHO PALOS VERDES, REDWOOD CITY, REEDLEY,)
RIDGECREST, ROLLING HILLS ESTATES, ROSEVILLE, SACRAMENTO, SAN)
BRUNO, SAN DIEGO, SANGER, SAN JOSE, SAN LEANDRO, SAN MATEO, SANTA)
CLARA, SANTA FE SPRINGS, SARATOGA, SELMA, SHAFER, SOUTH SAN)
FRANCISCO, TORRANCE, UNION CITY, WESTLAKE VILLAGE, WEST)
SACRAMENTO, WOODLAND, TOWN OF LOS GATOS, COUNTIES OF LOS)
ANGELES and SACRAMENTO, and CITY and COUNTY OF SAN FRANCISCO)

Case ID
469672

Petitioners)

Retailer:	Seller of equipment, fixtures, and supplies
Dates of Knowledge:	6/30/05, 03/29/08, 4/22/08, and 1/15/09
Allocation period:	6/1/06 – 12/31/11
Amount in Dispute:	\$1,955,220 ¹
Notification required:	None

This matter was scheduled for Board hearing on February 28, 2012, but was postponed at the request of Fillmore² because its city attorney was not available that day.

BACKGROUND

The retailer sells equipment, fixtures, and supplies (Retailer) to its parent and sole customer (Customer) pursuant to a Master Sale Agreement (MSA) entered into on May 1, 2006, for use in

¹ This is the disputed amount allocated by the retailer to Fillmore through December 31, 2011. If the jurisdictions in opposition to Fillmore prevail, the disputed amount would be reallocated as follows: \$555,541 to Moreno Valley; \$331,993 to the “March petitioners”; \$75,899 to the “June petitioners”; and, per operationally documented dates of knowledge, \$503,705 to countywide pool jurisdictions which are not petitioners in this appeal and \$488,152 to Woodland.

² Although Fillmore is a petitioner, it is in opposition to all other petitioners. Accordingly, to avoid confusion, we refer to Fillmore by name.

1 Customer's operations nationwide. Retailer's corporate headquarters is outside California, and it
2 maintains facilities outside California and two warehouses in California. Customer placed orders for
3 items maintained in Retailer's inventory online through Retailer's web site. To place orders of items
4 not maintained in Retailer's inventory, Customer contacted employees located at Retailer's out-of-state
5 headquarters by telephone, facsimile, or email. For the sales at issue here, the goods were shipped to
6 Customer by Retailer or directly by Retailer's vendors. Shipments from Retailer's California
7 warehouses were delivered by its own trucks; all other shipments were delivered by common carrier,
8 whether from Retailer's out-of-state facilities or directly from vendors facilities located both inside and
9 outside this state. Invoices were issued to Customer by Retailer's out-of-state headquarters.

10 Also on May 1, 2006, Retailer entered into an Agency Agreement with an unrelated third party
11 (UTP) that required UTP to open an office in Fillmore, which it did on June 1, 2006.³ The Agency
12 Agreement was entered into in connection with an Economic Development Agreement that UTP had
13 previously entered into with Fillmore in June 2003. Under these agreements, Fillmore pays UTP 85
14 percent of the local sales tax it receives from Retailer and retains only 15 percent. From its 85 percent
15 share, UTP pays Retailer between 50 and 80 percent of the local sales tax Retailer reports to Fillmore,
16 and UTP retains the remainder (i.e., 5 to 35 percent). On June 1, 2006, Retailer began reporting its
17 local tax as sales tax to the office of UTP in Fillmore, thereby gaining the right to 50 to 80 percent of
18 that tax as a rebate (if the allocation is upheld), based on the view that the Fillmore office performs the
19 principal negotiations and thus was the place of sale.

20 The petition filed by Moreno Valley was received by the Sales and Use Tax Department
21 Allocation Group (AG) on June 30, 2005. While AG was investigating that petition, the Sales and Use
22 Tax Department's Local Revenue Allocation Section (LRAS) operationally documented a new date of
23 knowledge on April 22, 2008. The petitions filed by the "March petitioners"⁴ were received by AG on
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26 ³ UTP also leases another office in Fillmore at the same location.

27 ⁴ Agoura Hills, Alameda, Albany, Berkeley, Beverly Hills, Calabasas, Campbell, Compton, Cupertino, Davis, El Monte,
28 Emeryville, Fremont, Gardena, Gilroy, Hawthorne, Hayward, Los Angeles, Milpitas, Morgan Hill, Palmdale, Palo Alto,
Pasadena, Rancho Cordova, Rancho Palos Verdes, Rolling Hills Estates, Sacramento, San Jose, San Leandro, Santa Clara,
Santa Fe Springs, Saratoga, Torrance, Union City, Westlake Village, West Sacramento, Woodland, Town of Los Gatos,
Counties of Los Angeles and Sacramento, and City and County of San Francisco

1 March 29, 2008; the petitions filed by the “June petitioners”⁵ were received by AG on June 30, 2008.
2 On August 4, 2008, AG notified Fillmore that a misallocation had occurred and that it intended to
3 deallocate the local tax distributed to Fillmore (and hold any further distributions beginning January 1,
4 2008). In response, Fillmore filed a timely petition on October 3, 2008. While preparing to issue its
5 decision, AG operationally documented a date of knowledge for Woodland on January 15, 2009. AG
6 issued its decision on May 19, 2009, granting the petitions of Moreno Valley and the March and June
7 petitioners and denying Fillmore’s petition. Fillmore timely appealed, and we issued our Decision and
8 Recommendation recommending that Fillmore’s petition be denied and that the petitioners in
9 opposition to Fillmore be granted.

10 UNRESOLVED ISSUE

11 Whether Retailer correctly reported the local tax beginning June 1, 2006, to the office located
12 in Fillmore. We conclude that for the goods delivered from inventories of Retailer’s out-of-state
13 facilities or its vendors, the local tax is allocable as use tax to the countywide pools of the places of
14 use; we conclude that for the goods delivered from inventories of Retailer’s California warehouses, the
15 local tax is allocable as sales tax to the location of the warehouse making the delivery.

16 Fillmore contends that the local tax was properly allocated directly to Fillmore because
17 Retailer’s only California sales office is the office leased and operated by UTP in Fillmore and such
18 office participated in the sales at issue.⁶ Fillmore argues that, in accordance with the MSA, the subject
19 sales were “sales on approval” and they were completed upon receipt at the Fillmore office of the
20 written notifications of approval delivered electronically each month.

21 The Department, with whom the petitioners other than Fillmore agree, contends that: for sales
22 shipped from Retailer’s or its vendors out-of-state facilities by common carrier, title passed at

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24 ⁵ Bakersfield, Belmont, Brisbane, Carlsbad, Chula Vista, Clovis, Daly City, Delano, Del Mar, East Palo Alto, El Cajon,
25 Escondido, Foster City, Fresno, Half Moon Bay, Kerman, Kingsburg, Menlo Park, Redwood City, Reedley, Ridgecrest,
Roseville, San Bruno, San Diego, Sanger, Selma, Shafter, San Mateo, and South San Francisco.

26 ⁶ Fillmore also argues that Retailer is entitled to a seller’s permit because it is a buying company, apparently without regard
27 to any other factor. That is, Fillmore apparently believes that every buying company not formed for the purpose of
28 redirecting local sales tax would be issued a California seller’s permit, even in the absence of any place of business, in-state
sales activity, or stock of goods. There is simply no basis for this belief since subdivision (h) of Regulation 1699 is not an
exception to the general rule provided by section 6066, interpreted by subdivision (a) of Regulation 1699. We do not
discuss permit arguments further.

1 shipment outside California and thus the tax is use tax allocable through the countywide pools of the
2 place of use; for sales delivered from Retailer's California warehouses in its own trucks, title passed in
3 California and thus the tax is sales tax allocable to the location of the warehouse making the delivery;
4 and, for sales delivered from the California facilities of Retailer's vendors, the tax is use tax allocable
5 through the countywide pools of the place of use because no California location of Retailer
6 participated in the sale.

7 The Department contends that the alleged activities of downloading, printing, and filing of the
8 emailed notifications of approval and approval lists are not actually performed in the Fillmore office
9 and thus do not provide a factual basis for allocation to Fillmore. The Department argues that the
10 photos provided by UTP show inconsistencies with statements made by its employee that she set up
11 the office in May 2006, and with information provided by the landlord in March 2008, which suggests
12 that the equipment was set up merely for purposes of taking the photos on July 6, 2010, and had not
13 been functionally used. That is, the Department asserts that: neither the photos nor schematic of the
14 Fillmore office provided by UTP show any installed equipment that could support obtaining a wireless
15 internet connection from another office (e.g., a router or wireless access card); some photos show no
16 cords or cables are attached to the computer and the keyboard unconnected; the photos show no
17 printer; and, the measurements of the file cabinet identified in the schematic indicate it could not hold
18 the volume of documents that UTP claims to have allegedly printed and filed at the Fillmore office.

19 The Department contends that even if the alleged activities were actually performed in the
20 Fillmore office, there is no basis for allocation to Fillmore as the activities have no substantive legal
21 effect and are not "sales on approval" such that title passes from Retailer to Customer on receipt of the
22 email (sent by Retailer) at the Fillmore office. The Department argues that the "sales on approval"
23 structure characterized in the MSA was not observed and there was no need for Retailer to undertake
24 the type of risk contemplated by a sale on approval as Customer was related to Retailer, captive to
25 Retailer, and had little or no choice as to what products would be supplied to it. The Department
26 asserts that, according to Retailer, the only change to the sales process as of June 1, 2006, was sending
27 the monthly notification of approval and approval list to the Fillmore office and this process involves
28 Retailer's out-of-state employees creating these documents and emailing them to the Fillmore office.

1 The Department argues that such process is controlled by Retailer's out-of-state employees, does not
2 involve any signed or dated purchase order or notification of approval or any kind of physical delivery
3 to the Fillmore office, and does not involve an approval transmitted to the Fillmore office by Customer
4 or any contact between the Fillmore office and Customer's employees. The Department also argues
5 that both the applicable law and the relevant terms of the MSA contemplate that Customer will take
6 affirmative action to accept or reject each item received, but Retailer described this process as not
7 involving Customer and occurring without its knowledge.

8 The initial issue in resolving this dispute is whether the applicable local tax is sales tax or use
9 tax. California Code of Regulations, title 18, section (Regulation) 1628, subdivision (b)(3)(D) explains
10 that title passes and the sale occurs when and where the retailer completes its performance with respect
11 to physical delivery of the property, unless the parties explicitly agree to pass title earlier. (Cal. U.
12 Com. Code, § 2401.) That is, title to the property can pass *prior* to delivery if the contract explicitly so
13 provides, but cannot pass any later than when the retailer completes its performance with respect to
14 physical delivery of the property, any retention or reservation by the retailer of title after that point
15 being limited in effect to a security interest. If the retailer is required to send the property to the
16 purchaser but is not required to deliver it at destination, usually pursuant to a F.O.B. destination
17 provision, the retailer completes its performance with respect to physical delivery at the time and place
18 the retailer delivers the property to the common carrier for shipment. (Cal. Code Regs., tit. 18, § 1628,
19 subd. (b)(3)(D).) If the contract provides F.O.B. destination, or if the retailer delivers the property
20 using its own facilities, the retailer completes its performance with respect to physical delivery when it
21 transfers the property to the purchaser at destination. (*Ibid.*) An exception to these delivery rules
22 exists where the sale is a "sale on approval" within the meaning of California Uniform Commercial
23 Code (UCC) section 2236. (See also Cal. Code Regs., tit. 18, § 1628, subd. (b)(3)(C).) Where a sale is
24 on approval, title does not pass, and the sale does not occur, until the purchaser actually accepts the
25 property (i.e., after delivery). (Cal. U. Com. Code, § 2327, subd. (1)(a).) A sale on approval is
26 generally one in which the delivered property may be returned by the purchaser even though it
27 conforms to the contract. (Cal. U. Com. Code, § 2326.) A sale on approval is a distinctive form of
28 contract and ordinary retail sales are not sales on approval. (Cal. U. Com. Code, § 2326, com. 1.) A

1 contract is not a sale on approval under UCC section 2326 by simply saying so. Any impediment to
2 the unconditional right to return the property prevents the sale from being on approval. (See Business
3 Taxes Law Guide annot. 495.0130 (04/03/81; 07/10/96) (an impediment includes making the right to
4 return the goods conditional upon failure to conform to the contract).) If an impediment prevents the
5 contract from being on approval, the sale is a conditional sale, and title passes in accordance with UCC
6 section 2401.

7 Here, section 7, subdivision (a) of Article II of the MSA provides for Customer to approve the
8 “fitness and conformity” of the goods. This clearly does not say, or contemplate, that Customer has an
9 unconditional right to return the goods, even if conforming to the contract specifications. Likewise,
10 neither the MSA’s definition of Offer (Art. I, § 11) nor its definition of Sale on Approval (Art. I, § 16),
11 explicitly give Customer an unconditional right to return the goods. For this reason and others set forth
12 in the D&R, we find that the subject sales were not sales on approval. Thus, since nothing in the MSA
13 requires delivery at destination, title to the goods passed, and the sales occurred, at the time and place
14 when Retailer completed its duties with reference to physical delivery of the goods. When delivery
15 was by common carrier, title passed and the sale occurred at the time and place where the Retailer or
16 its vendor tendered the goods to the common carrier for shipment to Customer; when delivery was by
17 Retailer’s own trucks, since Retailer completed its duties with reference to physical delivery upon its
18 tender of the goods to Customer as Customer’s California location, title passed and the sales occurred
19 in California at that time.

20 For sales delivered from out-of-state inventories of Retailer or its vendors, since title passed
21 and the sales occurred outside California, the state and local use tax applies. (Rev. & Tax. Code §§
22 6201, 7203; Cal. Code Regs., tit. 18, § 1803.) We thus conclude that the local tax should be
23 reallocated to the countywide pools of the places of use. (Cal. Code Regs., tit. 18, § 1802, subd. (d).)
24 For sales delivered from Retailer’s California inventories, since they occurred in California and
25 Retailer’s in-state warehouses participated in these sales, the state and local sales tax applies. (Rev. &
26 Tax. Code §§ 6051, 7202; Cal. Code Regs., tit. 18, § 1802.) However, whether any California location
27 of Retailer participated in the sale (i.e., Fillmore), and if so, the nature of that participation, is relevant
28 to where that local sales tax should be allocated. The final category of sales are those that were

1 tendered for shipment by common carrier by Retailer's vendors in California. Since Retailer (through
2 its vendors) completed its duties with reference to physical delivery of the goods when, on Retailer's
3 behalf, the vendors tendered the goods in California to common carriers for shipment to Customer, title
4 passed and the sales occurred in California. However, sales tax nevertheless is not the applicable tax
5 unless a California location of Retailer participated in the sale. Retailer's in-state warehouses did *not*
6 participate in those sales. Thus, as with the previous category, the participation if any by the Fillmore
7 location is relevant to the allocation of local tax.

8 The analysis necessary to determine whether a particular location is a place of business under
9 Regulation 1620, subdivision (a)(2)(A) (or for purposes of section 7205 and Regulation 1802) is the
10 same analysis required to determine if a particular location is, alone, a place of business of the retailer
11 supporting the imposition of a use tax collection duty on that retailer under section 6203, subdivision
12 (c)(1).⁷ Here, UTP operated the Fillmore location itself, from its own resources, and with no direct
13 reimbursement by Retailer or involvement with Retailer's Customer. Further, the evidence submitted
14 by UTP casts doubts on whether the purported activities were conducted at its Fillmore office. The
15 only evidence to support that such office was a place of business of Retailer is that Retailer's name is
16 listed on the building's directory. However, there was no evidence that Retailer even knew its name
17 was listed on the directory or that Retailer directed the landlord to put its name on that directory. Nor
18 was there any evidence, or even claim, that any of Retailer's employees worked in, at, or out of the
19 Fillmore office or that Retailer ever held that office out to Customer as its own place of business.
20 Thus, we conclude that the Fillmore office is UTP's own location and not that of Retailer, which
21 means that, if the Fillmore office were the only arguable business location of Retailer in this state, it
22 would not support imposition of a use tax collection duty on Retailer.⁸ Thus, the Fillmore office is not
23 a business location of Retailer for purposes of section 7205 or Regulations 1620, subdivision (a)(2)(A)

26 ⁷ Whether Retailer was engaged in business in this state within the meaning of section 6203 is not at issue. Without regard
27 to whether Retailer is regarded as having a location in Fillmore for purposes of section 6203, Retailer obviously has a very
28 clear and distinct physical presence in this state through its two California warehouses, and does not in any way dispute its
obligation to collect and remit the applicable use tax.

⁸ This means that Retailer was not properly issued a seller's permit for the Fillmore location under Regulation 1699.

1 and 1802.⁹ Therefore, for the sales delivered from California inventories of Retailer's vendors, no in-
2 state business location of Retailer participated in the sales, meaning that the applicable tax is the state
3 and local use tax. (Rev. & Tax. Code §§ 6201, 7203; Cal. Code Regs., tit. 18, § 1803.) We thus
4 conclude that such tax should be reallocated to the countywide pools of the places of use. (Cal. Code
5 Regs., tit. 18, § 1802, subd. (d).) For the sales delivered from Retailer's California warehouses that are
6 subject to state and local sales tax (as explained above), since the Fillmore location is not a place of
7 business of Retailer, such local tax cannot be allocated to Fillmore. We thus conclude that such tax
8 should be reallocated to the jurisdiction of the California warehouse (Moreno Valley or Woodland)
9 from which delivery was made pursuant to Regulation 1802, subdivision (c).

10 In summary, none of the local tax was correctly reported to Fillmore. Accordingly, we
11 recommend that the petitions of Moreno Valley and the March and June petitioners be granted and that
12 Fillmore's petition be denied. Thus, the local tax reported as sales tax to Fillmore for the period June
13 1, 2006, through December 31, 2011, should be reallocated as follows: \$555,541 to Moreno Valley;
14 \$331,993 to the March petitioners; and \$75,829 to the June petitioners. With respect to the
15 Department's operationally documented dates of knowledge, we recommend that \$503,705 be
16 reallocated to the non-petitioning countywide pool jurisdictions for the period July 1, 2007, through
17 December 31, 2011, and that \$488,152 be reallocated to Woodland for the period April 1, 2008,
18 through December 31, 2011.¹⁰

19 RESOLVED ISSUE

20 None of the parties requested a Board hearing as to the D&R's finding that LRAS operationally
21 documented a date of knowledge of April 22, 2008. Nor is there any dispute that the Fillmore office
22 was not used prior to June 1, 2006, and that Moreno Valley should receive a reallocation from the
23 various countywide pools of local tax of about \$129,753 on sales made from July 1, 2004, through
24 May 31, 2006.

25 _____
26 ⁹ Even if we had found that the Fillmore location were a business location of Retailer, the Fillmore location did not
27 participate in the sales within the meaning of section 7205 or Regulations 1620, subdivision (a)(2)(A) and 1802 because the
28 activities UTP claims occurred at that location had no meaningful effect on transactions that would have occurred in the
same basic way without regard to the activities conducted at the Fillmore location.

¹⁰ All amounts to be reallocated from Fillmore include the local tax which has not yet been distributed.

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OTHER DEVELOPMENTS

None.

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