

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Reallocation)
of Local Tax Under the Uniform Local Sales)
and Use Tax Law of:)
))
CITY OF MILPITAS) Case ID 571838
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Petitioner)

Retailer: Seller of computer hardware, software, and related products
Date of Knowledge: 6/30/09
Allocation period: 7/1/08 – 12/31/12
Amount in Dispute: \$317,864¹
Notification required: Cities of San Jose and Santa Clara

The retailer sells computer hardware, software, and related products (Retailer). Its sales to California customers were negotiated in Florida and the sales occurred (title passed) in California when the goods were drop shipped, via common carrier, directly to Retailer’s California customers by the manufacturer of the goods (Manufacturer) located in Milpitas, California. Manufacturer indicated that it stores a small amount of Retailer’s inventory as safety stock in a segregated space at Manufacturer’s Milpitas facility. Retailer estimated that of its sales to California customers, about 15 percent came from Retailer’s inventory stored at Manufacturer’s facility and about 85 percent came from Manufacturer’s own inventory stored at its facility. Retailer allocated the local tax as use tax through the countywide pools where the customers received the goods.

RESOLVED ISSUE

For the local tax on sales negotiated outside California and drop shipped by Manufacturer from Retailer’s safety stock located at Manufacturer’s facility (15 percent), it is now undisputed that these

¹ The retailer reported \$373,958 indirectly to the places of use through various countywide pools from July 1, 2008, through December 31, 2012, which is the amount petitioner seeks reallocated directly to it. Since the parties agree that petitioner should receive 15 percent of this amount (\$56,094), the amount in dispute is the remaining 85 percent (\$317,864).

1 sales were subject to the local sales tax, and that such tax should be reallocated to petitioner. We
2 agree. We recommend granting the petition as to such local tax.

3 UNRESOLVED ISSUE

4 Whether the local tax on Retailer's sales negotiated outside California and drop shipped by
5 Manufacturer from Manufacturer's inventory located at its facility (85 percent) should be reallocated to
6 petitioner as local sales tax. We conclude that these sales were subject to the local use tax, and that
7 there is thus no basis for reallocation of the local tax on such sales.

8 The Department contends that participation by Manufacturer at its own facility in the subject
9 sales does not support imposing sales tax on such sales for two reasons. First, at no time did Retailer
10 hold title to the disputed goods as stock for the purpose of making future sales since Retailer did not
11 gain title to the goods until Manufacturer tendered the goods to the common carrier for shipment, at
12 which time title passed from Manufacturer to Retailer and, instantaneously, to Retailer's customers.
13 Second, the location within Manufacturer's facility that constituted a place of business of Retailer,
14 where the safety stock was stored, did not participate in the disputed sales since none of the disputed
15 sales involve sales from the safety stock. The Department concludes the local tax is use tax that was
16 properly allocated through the countywide pools; San Jose agrees with the Department's reasoning and
17 conclusion.

18 Petitioner contends that the entire facility of Manufacturer is Retailer's place of business since
19 Retailer was required to hold a seller's permit under Regulation 1699, subdivision (a) for the small
20 area of the facility where Manufacturer stored Retailer's safety stock and that such place of business
21 participated in the subject sales.² Petitioner also contends that under the Board's memorandum
22 opinion in *Robert L. Reynolds and Donald R. Reynolds (5/31/07)*, commingled goods can support the
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26 ² In its opening brief, petitioner cites the Decision and Recommendation (D&R) for the proposition that, "It is undisputed
27 that the Milpitas location of [Manufacturer] is a place of business of [Retailer because it] is using the location for storing
28 those 15% of goods that are placed in the safety-stock." This is wrong. The D&R actually states that the parties agree that
the location *within* Manufacturer's facility where Manufacturer stored Retailer's safety stock on Retailer's behalf is a
business location of Retailer. The parties did not agree, and we did not find, that Manufacturer's *entire* facility is a business
location of Retailer. The parties' agreement, and our finding, is that only that portion of Manufacturer's facility where the
safety stock is stored constitutes a place of business of Retailer.

1 issuance of a seller's permit.³ Petitioner concludes the local tax is sales tax that should be reallocated
2 to it.

3 We conclude that the facts in *Reynolds* are completely different from those here, and that
4 petitioner ignores critical analysis of *Reynolds*. In *Reynolds*, the taxpayer shipped goods it owned to a
5 California location where the goods were held pending sale by the taxpayer. Here, at no time did
6 Retailer have title to the subject goods sold by Manufacturer except for the instant title passed through
7 Retailer to its customers upon Manufacturer's tender of the goods to the common carrier for shipment.
8 (Cal. U. Com. Code, § 2401, subd. (2); Cal. Code Regs., tit. 18, § 1628, subd. (b)(3)(D).)⁴ There was
9 never a moment that Manufacturer stored the subject goods while Retailer was the owner of those
10 goods.

11 A sale is subject to sales tax only if that sale occurs in California and a California location of
12 the retailer participated in the sale. (Cal. Code Regs., tit. 18, § 1620, subd. (a)(2)(A).) The same rules
13 are applicable to determine whether the local tax is sales tax. (Rev. & Tax. Code, §§ 7202, 7303; Cal.
14 Code Regs., tit. 18, § 1803.) Since the sales here did occur in California, the only dispute is whether
15 the California location that participated in those sales participated *as a location of Retailer*.

16 Manufacturer drop shipped the subject goods pursuant to the instructions of its purchaser,
17 Retailer. Only if that action constitutes participation in the sale *by Retailer* at that location would the
18 applicable tax be sales tax. However, the location of a drop shipper does *not* become a location of the
19 retailer simply because, pursuant to the retailer's instructions, the drop shipper ships the goods it sells
20 for resale to the retailer, to the retailer's customers. In its opening brief, petitioner argues that, since
21 Retailer was engaged in business in this state, we can ignore the implications of its argument in the
22 context of the drop shipment rule of Revenue and Taxation Code section 6007. This is simply not true.
23 If the disputed sales are found to be subject to sales tax because Retailer's California location (i.e.,
24 Manufacturer's location) participated in the sale, that would mean that Retailer was engaged in

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26 ³ We note that there were no commingled goods here.

27 ⁴ Petitioner's opening brief cites an email for the proposition that title passed from Manufacturer to Retailer and then to the
28 customer "at some point before [Manufacturer] loads the goods onto the truck for delivery to the California customer." The
cited email does not say this, nor are these the facts. Title passed at the point of shipment, and there was no point where
any of the disputed goods could be regarded as having been stored by Manufacturer except as the owner of the goods.

1 business in this state *by virtue of the disputed sales*. If that were the case, the drop shipment rule of
2 section 6007 could *never* apply to this type of situation because a person in Retailer’s situation would
3 be regarded as engaged in business in this state by virtue of Manufacturer’s drop shipments on its
4 behalf.

5 Thus, adopting petitioner’s view of drop shipments would render the drop shipment rule of
6 section 6007 a complete nullity as to drop shipments made from a California location of the supplier.
7 Under petitioner’s view, where a supplier drop ships goods from its California location to a California
8 consumer on behalf of a retailer not engaged in business in this state, the out-of-state retailer would be
9 regarded as having participated in the sale at the drop shipper’s location for purposes of Regulation
10 1620, subdivision (a)(2)(A). As such, the out-of-state retailer would be regarded as engaged in
11 business in this state solely by virtue of the drop shipment, which in turn means that the drop shipment
12 rule of section 6007 would not apply to the sale. Of course, if this were the correct interpretation of
13 drop shipments, there would be no “drop shipment rule” in the Sales and Use Tax Law. In its opening
14 brief, petitioner seeks to distinguish between drop shipments of goods in general inventory and those
15 manufactured specifically for the retailer so that the drop shipment rule would be rendered a nullity
16 only with respect to drop shipments of goods manufactured specifically for the retailer. For these
17 purposes, however, there is no valid legal distinction between the two situations.

18 Moreover, a person who holds a seller’s permit for a portion of the premises is not regarded as
19 participating in all selling activities conducted by another person in other areas of the premises solely
20 by virtue of holding the seller’s permit. For example, a jeweler who leases premises from the owner of
21 a mall who also operates the anchor retailer is not regarded as having participated in any sales made by
22 the anchor retailer simply because the jeweler holds a seller’s permit for a portion of the premises.
23 Retailer’s location at Manufacturer’s facility, that is, the location within that facility where the safety
24 stock was stored, did not in any way participate in the disputed transactions. Thus, *that location*
25 cannot be regarded as having participated in the subject sales.

26 We note that petitioner’s opening brief also misstates the facts and misapplies the case of
27 *Borders Online, LLC v. State Board of Equalization* (2005) 129 Cal.App.4th 1179 to those misstated
28 facts. Here, there is a general indication that Manufacturer performed repairs. Despite the petitioner’s

1 assumption in the opening brief that repairs are returns, in fact, repairs are not returns, and certainly not
2 returns of the type addressed in *Borders*, where a purchaser of goods from Borders Online was able to
3 return that item for cash or credit at a bricks and mortar location of the related Borders entity. Here,
4 there is no evidence that Manufacturer accepted returns on Retailer’s behalf as if it were the same legal
5 entity as Retailer (as in *Borders*) or otherwise.

6 We find that the only participation in the subject sales by Retailer was as a purchaser, and that
7 only Manufacturer and its employees participated in the disputed sales at Manufacturer’s facility. As
8 such, we find that the tax applicable to these sales under Regulation 1620, subdivision (a)(2)(A), was
9 use tax, and that the local use tax was properly allocated to the places of use through the respective
10 countywide pools. Thus, we recommend denying the petition as to the subject sales.

11 **OTHER DEVELOPMENTS**

12 None.

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