

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petitions for Reallocation)
 4 of Local Tax Under the Uniform Local Sales)
 and Use Tax Law of:)
 5)
 6 CITIES OF LOS ANGELES, SAN JOSE,) Case ID 472925
 & IRVINE)
 7)
 8 Petitioners)

9 Retailer: Printer
 10 Dates of knowledge: June 28, 1993 (San Jose and Los Angeles)
 June 26, 1997 (Irvine)
 11 Allocation periods: July 1, 1992 – March 31, 1997 (San Jose)
 12 July 1, 1992 – June 30, 1996 (Los Angeles)
 July 1, 1996 – June 30, 2001 (Irvine)
 13 Amount in dispute:¹ \$636,606 – City of San Jose
 14 \$224,465 – City of Los Angeles
 \$344,941 – City of Irvine
 15 Notification required: City of Merced

16 **BACKGROUND**

17 The petitions in this appeal were filed on June 28, 1993, and June 26, 1997. An appeals
 18 conference was held by the Local Tax Appeals Auditor within the Sales and Use Tax Department
 19 (Department), and his Decision and Recommendation (D&R) denying the appeal, issued on April 18,
 20 2001, found that the allocation method used by the Department was proper and that, based on that
 21 allocation method, a portion of the local sales tax allocated to petitioners Los Angeles and San Jose for
 22 the periods April 1, 1995, through September 30, 1995, should be reallocated to Merced (which we
 23 will refer to as “deallocate” to distinguish this process from the reallocations petitioners seek *from*

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 26 ¹ This figure is based on petitioners’ argument that the correct percentages for allocation were those used by the retailer for
 27 the period April 1, 1995, through September 30, 1995, which resulted in more local tax allocated to petitioners than the
 Department believes correct based on percentages developed by the Department with the retailer’s concurrence. If
 28 petitioners’ appeal is denied and the Department’s percentages are upheld, then the Department intends to reallocate local
 tax of \$22,238 from Los Angeles and \$54,007 from San Jose to Merced as recommended by the Decision and
 Recommendation.

1 Merced). Petitioners timely appealed that decision to Board Management, who issued its decision
2 denying the appeal on September 18, 2001. Petitioners did not take any action to request a Board
3 hearing until doing so by letters dated September 9, 2008. On January 21, 2009, the Board considered
4 that request and granted petitioners' request for hearing. That hearing was scheduled for July 22,
5 2009, but was postponed so that the Department could review this matter further. The hearing was
6 then rescheduled for October 6, 2009, but was postponed to allow the substantially affected jurisdiction
7 additional time to prepare for the hearing.

8 UNRESOLVED ISSUE

9 **Issue:** Whether local sales tax directly allocated to Merced should be reallocated to petitioners.
10 We conclude that there is no basis to reallocate local tax to petitioners, and that for the period April 1,
11 1995, through September 30, 1995, a portion of the local tax should be deallocated from petitioners
12 Los Angeles and San Jose to Merced in accordance with the D&R.

13 The retailer whose local sales taxes are the subject of these petitions was a printer with offices
14 in California whose business operations ended on September 30, 2005. The California locations at
15 issue include the offices in Merced, Los Angeles (this Los Angeles office located in Century City
16 moved to Irvine effective June 1, 1996), San Jose (this office moved to Pleasanton effective April 1,
17 1997), and Irvine (this office closed effective July 1, 2001). Prior to April 1, 1995, the retailer
18 allocated all California local sales tax to Merced. For the period April 1, 1995, through September 30,
19 1995, the retailer allocated its local sales tax as follows: 29.5 percent to Los Angeles; 68.2 percent to
20 San Jose; and 2.3 percent to Merced. For the period beginning October 1, 1995, the retailer again
21 began allocating all local sales tax to Merced, and did so until advised by the Department of the
22 allocation percentage and method the Department believed were correct, as discussed below.

23 In December 1996, the Department determined that in addition to the Merced office, the offices
24 in Los Angeles (and thereafter Irvine) and San Jose (and thereafter Pleasanton) negotiated sales and
25 that some reallocation was appropriate for the periods for which the retailer directly allocated all its
26 local tax to Merced. The Department tested the retailer's sales based on a sales analysis conducted by
27 the retailer matching recorded taxable sales with the retailer's various sales persons, and based on the
28 sale persons' accounts, the office each principally worked at, and where the contracts were principally

1 negotiated. For example, the retailer's sales analysis matched its Northwest Sales Vice President to the
2 retailer's largest customer (a utility company) at the Merced office. The retailer agreed that the sales
3 analysis on which the Department based its test was representative of the reallocation periods. In
4 calculating the percentages applicable to each office, the Department took into account that, beginning
5 January 1, 1994, the retailer commenced using a second location in Los Angeles, so that the applicable
6 percentages were adjusted effective January 1, 1994.

7 The Department concluded that for the reallocation periods prior to January 1, 1994, the local
8 tax should be reallocated based on the following percentages: 1.45 percent to Los Angeles, 0.42
9 percent to San Jose, and 98.13 percent to Merced. For the reallocation periods beginning January 1,
10 1994, the Department concluded that the local tax should be reallocated based on the following
11 percentages: 1.531 percent to Los Angeles, 0.204 percent to San Jose, and 98.265 percent to Merced.
12 Based on these percentages, reallocations from Merced to San Jose and Los Angeles were warranted
13 for the periods July 1, 1992, through March 31, 1995, and October 1, 1995, through March 31, 1997
14 (for Los Angeles through June 30, 1996,² and to Irvine thereafter), and deallocations from San Jose
15 and Los Angeles to Merced were warranted for the period April 1, 1995, through September 30, 1995.
16 The deallocations were held in abeyance pending the outcome of petitioners' appeal.

17 Petitioners contend that the Department did not reallocate the correct amount of local tax to
18 them, and argue that rather than the percentages used by the Department, the reallocations should have
19 been based on the allocation percentages the retailer used for the period April 1, 1995, through
20 September 30, 1995 (29.5 percent to Los Angeles until June 30, 1996, and then to Irvine through June
21 30, 2001, 68.2 percent to San Jose until March 31, 1997,³ and 2.3 percent to Merced). Petitioners
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23 ² If a location moves to another location within the same quarter, as here, the Department allocates the local tax reported for
24 that quarter to the location where the retailer operated the greatest number of days except when information is otherwise
25 provided. Since no information was provided to segregate the sales for the second quarter of 1996 between Los Angeles
26 and Irvine, the allocation period for the Los Angeles location ends on June 30, 1996, not May 31, 1996.

27 ³ This location moved to Pleasanton effective April 1, 1997. Pleasanton did not file a petition and is not a party to this
28 appeal. However, the Department documented a date of knowledge of November 26, 1997, for this location which would
allow a reallocation of local tax to Pleasanton from its commencement date to its date of closure, July 1, 2001, if there were
a misallocation. Accordingly, if the Board were to grant the petitions and reject the Department's position, the Department
would reallocate funds from Merced to Pleasanton for the period April 1, 1997, through June 30, 2001, on the same basis as
it would reallocate per the Board's order from Merced to San Jose for periods prior to April 1, 1997. The amount
reallocated would be approximately \$703,290. If the Board upholds the Department's position and denies the instant
petitions, there would be no basis for a reallocation to Pleasanton and none would be made.

1 assert that the sales in dispute were principally negotiated at the San Jose, Los Angeles, and Irvine
2 locations because that was where sales personnel were assigned and regularly worked, and that the
3 location where sales personnel actually worked when negotiations took place was not relevant.
4 Petitioners rely on Business Taxes Law Guide (BTLG) annotations 710.0005 (12/18/92), 710.0007
5 (5/19/92), 710.0009 (7/10/91), 710.0012 (12/28/90), and 710.0013 (7/18/91)⁴ to support their assertion
6 that “principal negotiations” for purposes of California Code of Regulations, title 18, section
7 (Regulation) 1802, subdivision (a), normally occur at a field sales office where sales personnel are
8 assigned to perform activities such as contacting customers, making presentations, and soliciting
9 orders.

10 Specifically, petitioners claim that since the retailer’s vice president, who interfaced with the
11 utility company customer, was assigned to and worked out of the San Jose office, that is where the
12 local tax should be allocated for the retailers sales to its major utility customer, and not to Merced,
13 where the documents for the utility company were printed. In support of its claim, petitioners provided
14 a letter received from the retailer’s vice president dated June 4, 1996, which indicates that “Account
15 Executives” operate out of two California sales offices, one in Irvine (previously Los Angeles) and the
16 other in San Jose. The retailer’s vice president stated, “At our two sales offices we work in market
17 research, prospect development from request for bid through signing contracts with customers to print
18 and bind. Once the contract is signed the job is taken over by an Account Manager at the printing
19 plant where the job will be produced. That individual is responsible for all communications within the
20 plant pertaining to that job and to the customer’s production team.” Petitioners also provided a letter
21 dated December 23, 1996, from the Department to the retailer memorializing a conversation with the
22 retailer’s vice president which indicated that a majority of the work at Merced came from major
23 customers such as the utility company customer, these customers had offices at the retailer’s office in
24 Merced, and sales contracts with those customers were negotiated in Merced.

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28 ⁴ Annotations are summaries of legal opinions by the Board’s attorneys, and are intended as research tools to provide
guidance regarding the interpretation of the law with respect to specific factual situations; annotations do not have the force
and effect of law. (Cal. Code Regs., tit. 18, § 5700, subs. (a)(1), (c)(2).)

1 On June 10, 1998, petitioners contacted the utility company's vice president in charge of
2 negotiating the contract with the retailer and provided notes of their discussion indicating that the
3 utility's vice president verified that preliminary negotiations (i.e., costs and procedures) with the
4 retailer occurred mainly at the Merced location and included the retailer's vice president, and that final
5 negotiations occurred by mail between the utility's vice president and his contact at the retailer's
6 headquarters in Connecticut. Consistent with this information, petitioners also provide a fax dated
7 June 22, 1998, that the Department received from the utility's vice president stating that "our contract
8 negotiations with [the retailer] take place primarily with officers in Tennessee and Connecticut.
9 Discussions within the state of California that are related to this contract, minimal as they may be, take
10 place in Merced, California. There the operational managers can provide specific details and
11 operational information to help us subsequently negotiate the contract."

12 These petitions involve only local sales tax. Local sales tax is allocated to the "place of sale."
13 (Rev. & Tax. Code, § 7205, subd. (a).) When the retailer has more than one place of business in this
14 state, as here, the place of sale is determined in accordance with Regulation 1802. (Rev. & Tax. Code,
15 § 7202, subd. (b)(1).) The applicable rules are set forth in Regulation 1802, subdivision (a)(2):

16 "(A) If a retailer has more than one place of business in this state but only one place of
17 business participates in the sale, the sale occurs at that place of business.

18 "(B) If a retailer has more than one place of business in this state which participate in
19 the sale, the sale occurs at the place of business where the principal negotiations are
20 carried on. If this place is the place where the order is taken, it is immaterial that the
21 order must be forwarded elsewhere for acceptance, approval of credit, shipment, or
22 billing. For the purposes of this regulation, an employee's activities will be attributed to
23 the place of business out of which he or she works."

24 Although subdivision (a)(2)(B) specifies the place of sale is where the principal negotiations
25 are carried on in California when one or more other California locations participate in the sale, it does
26 not specify the place of sale where the principal negotiations are conducted outside California and
27 more than one California location participates in the sale, nor does any other provision of Regulation
28 1802. We believe that the correct rule under such circumstances is that the place of sale is the
retailer's California location with the greatest participation in the sale. It is not clear from some of
petitioners' submissions if they are suggesting that the principal negotiations for the retailer's contract

1 with the utility company (and perhaps others) occurred outside California. To the extent that the
2 principal negotiations for the contract with the retailer's largest customer, or any other contract in
3 dispute, were conducted outside California, then we find that the local tax would be properly allocable
4 to the California location of the retailer with the greatest participation in those sales. Our
5 understanding of the facts is that the only arguable participation by the retailer's locations in
6 petitioners' jurisdictions is that employees who negotiated contracts may have been assigned to those
7 locations, while the actual physical negotiations occurred at the Merced location, which also printed
8 and delivered the products sold. Even assuming that the assignment of the negotiating employee to a
9 location constitutes that location's participation in the sale,⁵ we find that the participation by the
10 Merced location of the retailer must be regarded as the retailer's most significant California
11 participation in the sales since at least portions of the contract were negotiated by employees of the
12 retailer and its customer while those employees were physically situated at the Merced location, and
13 that location thereafter printed and delivered the products sold. Thus, if the principal negotiations
14 occurred outside California, we find that the petitions must be denied.

15 We reach the same conclusion for any of the disputed contracts for which the principal
16 negotiations occurred in California. If such were the case, as noted above, it is certain that the
17 negotiations were physically conducted by persons present at the Merced location of the retailer.⁶
18 Where more than one California location of the retailer participates in the sale, Regulation 1802,
19 subdivision (a)(2)(B), requires allocation to "the place of business where the principal negotiations are
20 carried on." Applying this provision to the facts here, petitioners contend that the principal
21 negotiations were not carried on at the retailer's business location where the participants in the
22 negotiations were physically located while carrying on those negotiations because the retailer's
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24 ⁵ If this does not constitute participation for these purposes, then based on our understanding of the facts, all of the disputed
25 local tax would have to be allocated to Merced under the provisions of Regulation 1802, subdivision (a)(2)(A), because the
26 Merced location would be the only location of the retailer in this state to have participated in the sales. The remainder of
the discussion treats such assignment as at least some participation by that location, which would thus implicate the
provisions of subdivision (a)(2)(B) of Regulation 1802.

27 ⁶ For the transactions where the negotiations were conducted by persons physically present at the retailer's locations other
28 than Merced, the local tax has already been allocated or reallocated to those locations. The local tax petitioners dispute are
from sales where the local tax has been allocated or reallocated to Merced based on the physical negotiations having been
conducted at the retailer's location in that jurisdiction.

1 employee was assigned to, and at other times worked out of, another location of the retailer. We
2 simply do not believe that the wording “the place of business where the principal negotiations are
3 carried on” is susceptible to this interpretation.

4 Petitioners’ argument is based on the last sentence of subdivision (a)(2)(B): “For the purposes
5 of this regulation, an employee’s activities will be attributed to the place of business out of which he
6 or she works.” We believe that petitioners’ interpretation would stand the meaning of the explicit
7 wording of the first sentence of the subdivision on its head. The wording in the last sentence of
8 subdivision (a)(2)(B) is required because many contracts are negotiated on a retailer’s behalf by a
9 person who is not physically present at any location of the retailer. For example, a retailer’s employee
10 may negotiate a sales contract during a visit to the customer’s location, or the employee may work
11 primarily out of his or her own home and may conduct negotiations by telephone from that location or
12 “on the road” while visiting customers. Thus, we do not believe that the sentence on which petitioners
13 rely was included to cover situations like those present here. In any event, to the extent that the
14 sentence does apply to the facts here, we find that an employee of the retailer who was physically
15 present at the Merced location to negotiate a contract on behalf of his or her employer *was* working out
16 of that location within the meaning of the wording on which petitioners rely, even if that employee
17 may have been assigned to another location. The annotations cited by petitioners are entirely
18 consistent with our analysis, but more accurately, they are not relevant to the circumstances here.

19 We find that the best available evidence shows that the retailer’s Merced location was the
20 primary California location where the retailer’s vice president discussed the terms of the contract with
21 the utility company, and that the Department properly regarded that location as the place of sale for
22 purposes of allocating the local tax on such sales directly to Merced under subdivision (a)(2)(B) of
23 Regulation 1802. We also find that petitioners have not established that any other local taxes allocated
24 or reallocated directly to Merced were incorrectly allocated. Accordingly, we recommend that the
25 appeal be denied and that for the periods April 1, 1995, through September 30, 1995, \$76,245 be
26 deallocated from Los Angeles (\$22,238) and San Jose (\$54,007) to Merced.

OTHER DEVELOPMENTS

Petitioners filed an opening brief disputing our recommendation. The Department and Merced each filed a reply brief disputing petitioners' position.

The only significant issue raised in these briefs is raised by Merced, who contends that any reallocation is barred because petitioners' request for Board hearing was not filed within a reasonable period of time. When the Board considered petitioners' request for hearing, the Appeals Division recommended that the hearing be denied because the appeal was already closed. We explained our view that, under petitioners' argument regarding the guidelines in effect prior to the original adoption of Regulation 1807, a denial by Board Management would never have been regarded as truly final, and we concluded this was an unreasonable interpretation. However, the Board rejected our recommendation and granted the hearing, which we understand as a finding that the matter does indeed remain open. As such, the appeal is open and not barred by Revenue and Taxation Code section 7209, the applicable statute of limitations. We note, however, that if the Board were to now find that the appeal was closed and that no reallocation should be made, the deallocation discussed above likewise would not be made.

Summary prepared by Trecia M. Nienow, Tax Counsel III (Specialist)