

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 IRVINE) Case ID 434851
Petitioner)

Retailer: Seller of integrated business software
Date of Knowledge: September 25, 1998
Allocation period: October 1, 1997 – March 31, 2010
Amount in Dispute: \$5,791,580¹
Notifications required: Cities of Anaheim, Costa Mesa, Cupertino, Fremont, Gilroy, Hayward, Long Beach, Los Angeles, Milpitas, Mountain View, Oakland, Palo Alto, Sacramento, San Diego, San Jose, Santa Ana, Santa Clara, and Sunnyvale; Counties of Los Angeles, and Sacramento; and, City and County of San Francisco

BACKGROUND

The petition in this appeal was received by the Sales and Use Tax Department (Department) on September 25, 1998. An appeals conference was held by the Local Tax Appeals Auditor and his Decision and Recommendation issued on August 31, 2006, recommending reallocating local use tax from the countywide pool of Orange County directly to petitioner in the amounts of \$43,324 for the period October 1, 1997, through September 30, 2002, and \$2,166 per quarter thereafter through the present, and otherwise denying the appeal. Petitioner timely appealed that decision to Board Management on October 31, 2006. This appeal was thereafter held up while the Business Taxes

¹ The Department calculates that the disputed local tax distributed through the applicable countywide pools for goods shipped by the retailer directly to California customers from out of state totals \$5,955,630. The Department estimates that petitioner already received about \$65,850 as its share of that distribution (the actual redistribution, if any, will be calculated using ratios reflected by the distribution of taxes collected from all taxpayers in Orange County for the quarter prior to the quarter the redistribution is effected). Thus, if petitioner were to prevail, the Department estimates the net redistribution to petitioner would be \$5,889,780. If, instead, our recommendation is upheld to grant a portion of the petition in accordance with the Decision and Recommendation and deny the remainder, as discussed below, the Department estimates the net redistribution to petitioner would be about \$98,200.

STATE BOARD OF EQUALIZATION
UNIFORM LOCAL SALES AND USE TAX APPEAL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

1 Committee considered whether to make an amendment to California Code of Regulations, title 18,
2 section (Regulation) 1803 which might support a different result in this matter. At its May 31, 2007
3 meeting, the committee considered whether Regulation 1803 should be amended to reclassify
4 transactions involving goods shipped into California from outside the state, with title passing outside
5 the state, as subject to local sales tax, not use tax, when the out-of-state retailer's place of business in
6 California participates in the transaction, such as occurred here. The committee voted unanimously to
7 not amend Regulation 1803. The Board approved the recommendation of the committee on June 1,
8 2007. Petitioner's appeal was thereafter denied by Board Management on June 30, 2008. On
9 September 29, 2008, petitioner submitted a timely written request for Board hearing.

10 **UNRESOLVED ISSUE**

11 Whether local sales tax which should be directly allocated to petitioner applies to sales for
12 which orders were taken at the retailer's Irvine office for goods shipped to California customers from
13 out of state. We conclude that these sales occurred outside California and were thus subject to local
14 use tax, which was correctly allocated to the countywide pool of the place of use.

15 The retailer whose local taxes are the subject of this petition took orders of pre-written business
16 software at its California office located in Irvine and its parent company shipped the software on
17 tangible storage media directly to customers by common carrier, F.O.B. origin (shipping point), from a
18 stock of goods located in Europe. The retailer thereafter installed the software, provided training, and
19 optionally provided maintenance and support. The retailer reported the transactions in dispute as use
20 tax and allocated the local tax through various countywide pools of the place of use (i.e., where the
21 customers received the goods).

22 The Department contends that the transactions occurred outside California because title passed
23 outside California at the time of shipment, meaning that the applicable tax was use tax. (Cal. U. Com.
24 Code, § 2401; see Cal. Code Regs., tit. 18, § 1628, subd. (b)(3)(D).) Petitioner contends that the
25 transactions occurred in California after the retailer's customer received and accepted the goods that
26 had been shipped from outside California. Petitioner argues that, rather than applying the provisions of
27 Uniform Commercial Code (UCC) section 2401, which it believes should be ignored when
28 determining the time and place of sale or use for purposes of sales and use taxes, the other non-title

1 provisions of the UCC should be deemed as controlling. That is, petitioner asserts that the transactions
2 took place in California after the retailer's customers gained possession of the goods, when the
3 customers, typically after installation, inspected and accepted the goods (or failed to reject them) in
4 accordance with UCC sections 2513 and 2606. Petitioner also argues that title passed through the
5 retailer in California when the goods were sent by the parent company from Europe even though the
6 goods were shipped by common carrier, F.O.B. shipping point, directly to the purchasers.

7 Contrary to petitioner's interpretation, we find that UCC section 2401 may not be ignored for
8 these purposes, and we note that section 2401 itself provides that the rights, obligations, and remedies
9 of parties to a contract are determined by other provisions of the UCC insofar as title is *not* relevant.
10 Where the UCC provides that one or both of the parties has a right, remedy, or obligation at a specific
11 time, then that party has that right, remedy, or obligation at that time without regard to whether title
12 has passed under section 2401. In other words, a customer has the right of inspection and acceptance
13 under UCC sections 2513 and 2606 even though title may have already passed under section 2401
14 before that customer obtained the right to inspect or accept the goods. Here, the orders taken by the
15 retailer were for goods delivered by common carrier from out of state, F.O.B. shipping point, meaning
16 that title passed and the transactions occurred outside California at the place of shipment, even when
17 installation by the retailer in California was mandatory. (Cal. U. Com. Code, § 2401; see Cal. Code
18 Regs., tit. 18, §§ 1628, subd. (b)(3)(D), 1803, subd. (a)(1).) Since title passed and the sale occurred
19 outside California, the state sales tax does not apply, even though the local office of the retailer
20 participated in the transactions. (Rev. & Tax. Code, §§ 6010.5, 6051 (sales tax applicable only to retail
21 sales "in this state"); Cal. Code Regs., tit. 18, § 1620, subd. (a)(2)(A).) Accordingly, the local sales tax
22 imposed under the Uniform Local Sales and Use Tax Law cannot apply to the subject transactions.
23 (Rev. & Tax. Code, §§ 7202, 7203; Cal. Code Regs., tit. 18, § 1803, subd. (a)(1).)²

24
25
26
27 ² Contrary to petitioner's argument in its appeal to Board Management, Revenue and Taxation Code section 7205 is not
28 determinative of *whether* local sales tax applies, but rather to where the local sales tax is allocated *if* the local tax is sales
tax. Accordingly, section 7205 is wholly irrelevant to circumstances here where the local tax is use tax: the provisions of
section 7205 do *not* transmute a local use tax into a local sales tax.

1 While we certainly agree with petitioner that title to the property sold passed from the supplier
2 (parent company) to the retailer before title was transferred to the purchaser, that clearly does not mean
3 title passed to the retailer *inside* California. Title passed from the supplier to the retailer in accordance
4 with the rules discussed above. Since the supplier shipped the goods (pursuant to the instructions of
5 the retailer) F.O.B. shipping point to the consumer, title passed from the supplier to the retailer at the
6 point of shipment, and then immediately passed from the retailer to its purchaser. Thus, we agree that
7 title passed through the retailer (similar to any other drop shipment transaction), but that occurred
8 outside California.

9 We recommend that the petition be denied except as to the resolved issue discussed below.

10 **RESOLVED ISSUE**

11 We find that the local use tax should be directly allocated to petitioner where goods were
12 shipped from outside the state directly to customers at their place of use in Irvine and the transactions
13 were \$500,000 or more. (Cal. Code Regs., tit. 18, § 1802, subd. (d)(1).) The Department determined
14 this amount to be \$43,324 for the period October 1, 1997, to September 30, 2002 (i.e., quarterly
15 average is \$2,166). Since the retailer continues to misallocate local use tax for transactions of
16 \$500,000 or more where the place of use is Irvine, we conclude that local use tax allocated to the
17 countywide pool of Orange County should be reallocated directly to petitioner in the amount of
18 \$43,324 for the period October 1, 1997, through September 30, 2002, and \$2,166 for the period
19 October 1, 2002, through the end of the current quarter, less the amount petitioner already received as
20 its share of the countywide pool from the retailer's misallocation of local tax to that pool. Had this tax
21 been allocated properly, the Department estimates that petitioner would have received about \$98,200
22 more than it received, and we recommend granting the petition as to such amount.

23 **OTHER DEVELOPMENTS**

24 None.

25
26 Summary prepared by Trecia M. Nienow, Tax Counsel III (Specialist)