



STATE BOARD OF EQUALIZATION

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May 14, 2004

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Dear Interested Party :

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the May 25, 2004 Business Taxes Committee meeting. This meeting will address the issuance of a seller's permit to Lands' End's location.

Action 1 on the Agenda concerns approval of either the staff recommendation to deny a seller's permit for the Ontario location or Land's End's request for issuance of a seller's permit to the Ontario location.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your input on these issues and we look forward to your attendance at the Business Taxes Committee meeting at **9:30 a.m.** on **May 25, 2004** in Room 121 at the address shown above.

Sincerely,

Stephen R. Rudd
Acting Deputy Director
Sales and Use Tax Department

SRR: lk

Enclosures

cc: (all with enclosures)
Honorable Carole Migden, Chairwoman
Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable John Chiang, Member, Fourth District

Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel
Ms. Carole Ruwart, Board Member's Office, First District (MIC 71)
Ms. Sabina Crocette, Board Member's Office, First District
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Tim Treichelt, Board Member's Office, Second District (via e-mail)
Mr. Michael Thomas, Board Member's Office, Fourth District (MIC 72)
Ms. Sylvia Tang, Board Member's Office, Fourth District (MIC 72)
Mr. Ramon J. Hirsig (MIC 73)
Mr. Timothy Boyer (MIC 83)
Ms. Janice Thurston (MIC 82)
Mr. Jeffrey H. Graybill (MIC 82)
Mr. John Waid (MIC 82)
Ms. Carla Caruso (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Mr. Rey Obligacion (via e-mail)
Mr. Todd Gilman (MIC 70)
Mr. Dan Tokutomi (via e-mail)
Mr. Dave Hayes (MIC 67)
Mr. Joseph Young (via e-mail)
Mr. Jerry Cornelius (via e-mail)
Mr. Jeffrey L. McGuire (MIC 92 and via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Laureen Simpson (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Cecilia Watkins (MIC 50)

AGENDA — May 25, 2004 Business Taxes Committee Meeting
Issuance of a Seller's Permit to a Lands' End's Location Where Only Credit Checks are Performed

Action 1 — Issuance of a Seller's Permit to Lands' End Ontario location.

Issue Paper – Staff recommendation.

Approve either:

Staff's recommendation to not issue a seller's permit to Lands' End for an Ontario location, where Land's End plans to have an employee run secondary customer credit checks, for the following reasons:

- The order is sent by the purchaser directly to Lands' End at a point outside California, the property is shipped to the California purchaser from a point outside this state directly to the purchaser in California, and the activities performed by the Ontario employee do not constitute "participation in the sale."
- Sales to California customers will occur out of state when property is transferred to the U.S. Postal service or UPS (Land's End's common carriers) for delivery to California. There is no evidence of an express agreement with customers requiring delivery at destination in California such as a delivery term F.O.B. (free on board) destination.

Under the staff recommendation, Land's End will retain its' Certificate of Registration – Use Tax and continue to collect and report the use tax on sales to California customers. The local portion of the use tax will continue to be allocated through the medium of the countywide pool of the "ship to" address on each sales order.

OR

Approve Lands' End application for a seller's permit for a planned City of Ontario location on the basis that sales tax applies to their California sales for the following reasons:

- The activities of the Lands' End employee in Ontario will qualify as "participation in the sale" when such employee conducts a secondary credit check (verifying that proper reports are run in California on each batch of orders received, and analyzing the results of those reports) at Lands' End's Ontario office as a condition precedent to the final approval and shipment of a California order.
- The sale of the property occurs in California because Lands' End makes its deliveries of product on a F.O.B. destination basis.

Under this alternative, Land's End would be required to report sales tax on California sales that undergo credit checks in Ontario. The local portion of sales tax would be allocated to the City of Ontario because the Ontario office would be Lands' End's only business location in California.

Issue Paper – Alternative 1.

Issue Paper Number 04-003



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Discussion Regarding Issuance of a Seller’s Permit to Lands’ End’s Location Where Only Credit Checks are Performed

I. Issue

Should a sales tax permit be issued to Lands’ End, an out-of-state retailer who currently collects and reports use tax, if title to the property passes in-state and the retailer’s sole activity at its in-state location is performing customer credit checks which activity previously has not been considered sales negotiation? If so, the incidence of tax would shift from consumers to the retailer, and the allocation of the local portion of the tax collected would shift from cities and counties where the buyers reside to the local government where the credit check activity is performed.

The Board’s decision in this matter would not affect the total amount of tax reported by Lands’ End but would affect the allocation of the local portion of the tax to cities and counties in California.

II. Staff Recommendation

Staff recommends that the Board not issue a seller’s permit to Lands’ End for an Ontario location, where Lands’ End plans to have an employee run secondary credit checks, for the following reasons:

- The order is sent by the purchaser directly to Lands’ End at a point outside California, the property is shipped to the California purchaser from a point outside this state directly to the purchaser in California, and the activities performed by the Ontario employee do not constitute “participation in the sale.”
- Sales to California customers will occur out of state when property is transferred to the U.S. Postal service or UPS (Land’s End’s common carriers) for delivery to California. There is no evidence of an express agreement with customers requiring delivery at destination in California such as a delivery term F.O.B. (free on board) destination.

Under the staff recommendation, Land’s End will retain its’ Certificate of Registration – Use Tax and continue to collect and report the use tax on sales to California customers. The local portion of the use tax will continue to be allocated through the medium of the countywide pool of the “ship to” address on each sales order.

See Issue Paper (IP) pages 7-15 and agenda action item 1 for additional information.

III. Other Alternative Considered

Messrs. Michael D’Addio, Rex Halverson, and Dean Andal of KPMG LLP (KPMG) propose the following:

Approve Lands’ End application for a seller’s permit for a planned City of Ontario location on the basis that sales tax applies to their California sales for the following reasons:

- The activities of the Lands’ End employee in Ontario will qualify as “participation in the sale” when such employee conducts a secondary credit check (verifying that proper reports are run in California on each batch of orders received, and analyzing the results of those reports) at Lands’ End’s Ontario office as a condition precedent to the final approval and shipment of a California order.
- The sale of the property occurs in California because Lands’ End makes its deliveries of product on a F.O.B. destination basis.

Under this alternative, Land’s End would be required to report sales tax on California sales that undergo credit checks in Ontario. The local portion of sales tax would be allocated to the City of Ontario because the Ontario office would be Lands’ End’s only business location in California.

See IP pages 17-18, Exhibit 2, and agenda action item 1 for additional information.

IV. Background

At the Board meeting on February 18, 2004, following extensive correspondence with staff beginning in mid-2003, this issue was brought before the Board as a discussion item. KPMG, representing Lands' End, requested that the Board issue a seller's permit to Lands' End for the Ontario operation. The Board referred the matter to the Business Taxes Committee and it is scheduled for discussion at the Committee's May 25, 2004 meeting.

Lands' End is currently engaged in business in California and holds a Certificate of Registration – Use Tax. It collects and reports local use tax to all California local jurisdictions through the medium of the countywide pool system¹. If Lands' End were issued a seller's permit, it would report all local sales tax to the City of Ontario.² The issue to be decided is whether sales tax applies instead of use tax. The amount of tax Lands' End pays to the state would remain unchanged, but the incidence of tax would change. If sales tax applies, tax would be imposed on Lands' End, not on the in-state consumers. As a result, the allocation of the local portion of the tax collected would shift from cities and counties where the buyers reside to the city where the Lands' End credit (bankruptcy and fraud) checking activity is performed (the City of Ontario).

Interested Parties Submission

Staff met with interested parties on April 1, 2004, to discuss the requirements necessary for the issuance of a seller's permit and the impact of the distribution of the local tax on cities and counties in California. In response to these discussions, staff received comments from the following interested parties who have taken a position regarding the issue.

Opposing permit issuance:

Mr. David McPherson of the City of San Jose, in a letter dated April 12, 2004.
Mr. Matt Hinderliter of the HdL Companies, in a letter dated April 14, 2004.
Mr. Bob Anderson, Chairman, Sonoma County Open Space Authority, in a letter dated April 15, 2004.
Ms. Jacquelyn Acosta of the City of Carson, in a letter dated May 3, 2004.
Mr. Morris Vance, Mayor of the City of Vista, in a letter dated March 31, 2004.
Messrs. Gene Rogers and Steven Chapman of the City of Moreno Valley, in a letter dated March 29, 2004.

Supporting permit issuance:

Mr. Michael D'Addio of KPMG, in letters dated April 9 and 14, 2004.
Mr. Rex Halverson and Mr. Dean Andal of KPMG, in a letter dated April 12, 2004.
Mr. Bill Dombrowski of the California Retailers Association (CRA), in a letter dated April 13, 2004.

¹ Countywide pool is a system to allocate the local portion of the sales or use tax reported, under certain circumstances. For out-of-state sellers who ship goods directly to consumers in the state from a stock of goods located outside the state, the use tax is not identified with a specific registered place of business and the tax generally is allocated to the local jurisdictions in the county of use through a countywide pool. These taxpayers are issued an additional schedule (*Schedule B - Detailed Allocation by County of 1 Percent Uniform Local Sales and Use Tax*) with their sales and use tax returns to report their local tax. *Schedule B* lists each county within the state of California, and use tax should be entered opposite the county of use. At the end of each reporting quarter, the countywide pool totals are prorated among the cities, redevelopment areas, and the unincorporated area of each county using the proportion that the directly-reported tax for each city and unincorporated area of a county bears to the total directly-reported tax for the county as a whole.

² Even if the Board chooses to issue Lands' End a seller's permit for the Ontario location, such issuance of a seller's permit does not render all transactions subject to sales tax. Staff notes that for any given transaction, if there is no local participation in the sale or if the sale does not occur in California (as more fully described below), sales tax does not apply, and the transaction will be subject to use tax.

Those comments in support of the staff recommendation opposing issuance of a seller's permit are summarized in Section V of this paper, Staff Recommendation. Those comments in support of issuing a seller's permit to Lands' End's office in Ontario are summarized in Section VI, Alternative 1.

Staff also received comments from the following interested parties who did not take a position on the issue:

- In letters dated April 14, 2004 on behalf of their members, the League of California Cities (LCC), the California Society of Municipal Finance Officers (CSMFO), and the California State Association of Counties (CSAC) requested that the Business Taxes Committee postpone its May 25, 2004 discussion of this issue to allow further interested parties participation and to provide additional time to review and analyze the potential impact of this decision on other sales and use tax determinations.
- In a letter dated April 14, 2004, Mr. Albin Koch of MBIA MuniServices/MRC (MBIA) opposed any proposed amendments to regulations and stated that the Board should decide this case on its own merits. He believes the best interest of local jurisdictions and the state will be served by preserving the present sales-office orientation of the situs distribution rules for Bradley-Burns local tax revenues. In addition, MBIA (1) encouraged the Board to support establishing standards for the use of economic incentives by local government and help formulate what the standards might be; and (2) expressed his belief that there is no constitutional basis for establishing a "substantial in-state activity" nexus standard for applying the sales tax to a taxpayer's sales activities conducted in a local jurisdiction.

The April 1, 2004 interested parties meeting also focused on staff's preliminary recommendation in the discussion paper dated March 19, 2004 to amend Regulation 1620. Staff had recommended amending the language in Regulation 1620(a)(2) to clarify current rules and policies to the extent the existing regulatory language had been misinterpreted. After hearing concerns regarding any amendments to regulations from parties on both sides of the Lands' End issue, staff has reconsidered the need to clarify the regulatory language at this time and is no longer recommending that the regulation be amended. As discussed in this paper, staff remains of the opinion that the United States Constitution, and Board regulations promulgated thereunder support Lands' End having a use tax collection obligation rather than a sales tax obligation.

Sales versus Use Tax Obligation

Under the California Sales and Use Tax Law, charges for a transfer of tangible personal property for consideration are subject to sales or use tax unless excluded or exempt. Sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. (Revenue and Taxation Code (RTC) section 6051). The use tax is complementary to the sales tax and is imposed on the storage, use or other consumption of tangible personal property purchased from any retailer for storage, use or other consumption in this state. (RTC section 6201.) The obligation to pay use tax is on the consumer. (*Ibid.*) However, if an out-of-state retailer is engaged in business in this state as defined in RTC section 6203 (Exhibit 3), it is required to register with the Board and collect the use tax from the consumer at the time of making the sale. The sales tax and the use tax are at the same rate.

For sales tax purposes, Regulation 1699(a), *Permits* (see Exhibit 4), states in part that "Every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers. For example:

A permit is required for a branch sales office at which orders are customarily taken and contracts negotiated, whether or not merchandise is stocked there."

The regulation also specifies that, “No additional permits are required for warehouses or other places at which merchandise is merely stored and which customers do not customarily visit for the purpose of making purchases and which are maintained in conjunction with a place of business for which a permit is held; but at least one permit must be held by every person maintaining stocks of merchandise in this state for sale.” (Reg. 1699(a).)

For purposes of the Sales and Use Tax Law, the place of the sale or purchase of tangible personal property is the place where the property is physically located at the time the act constituting the sale or purchase takes place. (RTC section 6010.5). However, for purposes of the Bradley-Burns Local Sales and Use Tax Law, different rules apply – see “Allocation of Local Tax” on page 5. (Regulation 1628(b)(4) – Exhibit 7).

Regulation 1620(a)(1) (Exhibit 5) provides in part that when a sale occurs in this state, the sales tax is not rendered inapplicable solely because the sale follows a movement of the property into this state from a point outside its borders. Such movements prevent application of the sales tax only when conditions exist under which the taxing of the sale is prohibited by the United States Constitution or there exists a statutory exemption. Subdivisions (a)(2)(A) and (a)(2)(B) of the regulation define the conditions when sales tax does and does not apply, as follows:

“Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any local branch, office, outlet or other place of business of the retailer in this state... *and* the sale occurs in this state... Participation in the transaction in any way by the local office, branch, outlet or other place of business is sufficient to sustain the tax.” (Reg. 1620(A)(2)(A), emphasis added.)

“Sales tax does not apply when the order is sent by the purchaser directly to the retailer at a point outside this state, or to an agent of the retailer in this state, and the property is shipped to the purchaser, pursuant to the contract of sale, from a point outside this state directly to the purchaser in this state... provided there is no participation whatever in the transaction by any local branch, office, outlet or other place of business of the retailer....” (Reg. 1620(a)(2)(B).)

If the use tax applies and the sales tax does not apply, every retailer engaged in business in this state and making sales of tangible personal property, the storage, use or other consumption of which is subject to the use tax, must register with the Board, collect the tax from purchasers and report it to the State. A typical use tax transaction occurs when a retailer ships tangible personal property via common carrier from outside California to a purchaser in this state. Since the sale occurs outside the state (because title passes outside California)³, sales tax does not apply and the extent of participation by an in-state location of the retailer is irrelevant. (Reg. 1620(a)(1).)

³ See footnote 12 for discussion of passage of title and place of sale.

When tangible personal property is shipped from out of state by common carrier F.O.B. destination⁴ or by the retailer's own vehicles so that title is passed inside this state, use tax also applies unless an in-state office of the retailer actually participates in the *sale* transaction. (Reg. 1620(a)(2)(A); U.S. Const., art. I, sec. 8, cl. 3 (Commerce Clause); U.S. Const., 14th Amend. (Due Process Clause); *General Motors Corporation v. Washington* (1964) 337 U.S. 436, overruled on other grounds in *Tyler Pipe. v. Washington* (1987) 483 U.S. 232, 248) Under these conditions, it is this participation in the *sale* transaction by the in-state office of the retailer that supports the imposition of the sales tax.

All parties agree that Lands' End is currently engaged in business in California within the meaning of RTC section 6203 and is therefore required to register with the Board and collect the use tax from California consumers. The disagreement between Lands' End and staff is whether the sales tax rather than the use tax applies to Lands' End transactions, based on the facts presented and based on the interpretation of regulatory provisions and Board policies, and will be discussed in the following sections. Since the sales and use tax are at the same rate and since Lands' End is currently registered with the Board to collect and report the use tax, the impact of this case is primarily on the distribution of the local portion of the tax to local jurisdictions (cities and counties).⁵

In summary, an out-of-state retailer with a California office has a use tax collection obligation for sales to California customers when title to the goods transfers to the California customer *outside* this state. (Reg. 1620(1)(a).) An out-of-state retailer with a California office may have a use tax collection obligation *or* a sales tax obligation for sales to California customers when title to the goods transfers to the California customer *inside* this state; the determination whether that sale is subject to sales tax or use tax depends upon the participation of the retailer's California office in the *sale*. Participation in the *sale* transaction by the in-state office is required for the imposition of sales tax.

Allocation of Local Tax

Subdivision (c) of Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes* (Exhibit 6), explains that the local *sales* tax is allocated to the place where the sale is deemed to take place under subdivisions (a) and (b) of the same regulation. Subdivision (a) provides that if a retailer has one place of business in this state, all California retail sales of that retailer occur at that place of business unless the tangible personal property sold is delivered to an out-of-state destination. On the other hand, Regulation 1802, subdivision (c)(1) more specifically provides that when the order for property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state, the transaction is subject to the local *use* tax ordinance where the first functional use is made.⁶

⁴ See footnote 10 for the definition of "F.O.B. (free on board) destination," set forth in the California Uniform Commercial Code.

⁵ Lands' End will still remain engaged in business in the various districts in which Sears stores are located and is thus required to collect district use taxes. These taxes are reported for each district on Lands' End's quarterly sales use tax returns.

⁶ Merely having an office in California does not mean that the office is entitled to a seller's permit. RTC section 6203, in requiring a retailer to collect use tax when engaged in business in California, anticipates that the retailer may have a physical location in California and that physical location in California, while giving rise to use tax nexus, does not mean that the office should have a seller's permit.

Applying these rules to the Lands' End case, if the applicable tax is determined to be the use tax, the local portion of the tax collected will continue to be allocated to the jurisdictions of the California consumers through the medium of the countywide pools system. On the other hand, if the Board determines that the transactions will be subject to sales tax, all of the local tax generated from Lands' End sales in California will be distributed to the City of Ontario, the local jurisdiction where Lands' End proposes to have a credit check operation.

Description of Lands' End's Proposed Activities in This State

KPMG describes a business operation that Lands' End proposes to set up in the City of Ontario, California.⁷ The proposal is to obtain space⁸ at a direct distribution center belonging to its parent corporation, Sears Roebuck & Co., located in the City of Ontario,⁹ for use by the employee doing credit checks on the Sears database. Approximately 2,400-5,400 credit checks will be processed daily. If the Lands' End employee assigned to this desk is sick or on vacation, an employee of the parent will be assigned to perform the credit-check duties, and Lands' End will pay its parent for the use of the employee.

California customers, like other customers around the country, will place their orders through telephone, mail, or Internet for Lands' End's products through the order desk in Dodgeville, Wisconsin, where its corporate headquarters is located. Lands' End ships its products to its customers by United Parcel Service ("UPS") or the United States Postal Service ("U.S. Postal Service"). (See www.landsend.com.) Before the orders are preliminarily approved, they undergo two electronic out-of-state credit checks to verify that the credit card used to place the order is valid and that it was not stolen. Additionally, Lands' End plans to have the orders from California customers electronically sent to the Ontario office in batches to undergo a third check using the Sears Fraud File. The file contains consumer credit scores and bankruptcy filing data to verify that a customer has not recently filed for bankruptcy. After the electronic comparison is made, a report is generated in Ontario. If the order is approved, it is sent directly to an out-of-state distribution center to be filled. If rejected, the order is sent to Wisconsin for further inquiry by a Wisconsin customer service representative. The in-state employee does not contact the customer or gather additional information. Lands' End states that the main responsibilities of the employee in Ontario will be to verify that the proper reports are run on each batch of orders received, analyze the reports and communicate with Lands' End's other facilities. Additionally, the employee will be responsible to keep the database updated by downloading monthly updates to the Sears Fraud File, to maintain records (electronic and print), and to ensure that the hardware and software is functioning properly.¹⁰

⁷ The City of Ontario's website indicates that Ontario has a location agreement with Lands' End's parent, Sears Roebuck & Co., under which the city estimates it will retain in excess of \$600,000 in local sales tax revenues, and the retailer will obtain local sales tax reimbursement of 50% in the first 5 years, 40% in the next 5 years, and 30% in the following 5 years to offset its costs of investment in information technology and systems and the site selection process. (City Council minutes, July 15, 2003: www.ci.ontario.ca.us/index.cfm/search/22/6008; see also www.ci.ontario.ca.us/index.cfm/search/22/6835.)

⁸ The correspondence indicates this space consists of a desk and a computer.

⁹ The direct distribution center cannot qualify for a seller's permit on its own as the parent has numerous stores in this state. (Reg. 1802(b)(5).)

¹⁰ The latest submissions from KPMG indicate that the credit check operation in California has not yet commenced.

Lands' End ships its products from Dodgeville, Wisconsin directly to its customer via UPS or the U.S. Postal Service. (See www.landsend.com.) KPMG states that Lands' End products are shipped to California customers "F.O.B. destination," and has attached an affidavit signed by an official at Lands' End to that effect. (See Exhibit 2, page 13.) When the retailer ships property via common carrier F.O.B. destination¹¹ from a point outside this state to the consumer in this state, title to the property passes upon delivery to the consumer in California and the sale occurs in this state.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that the Board deny KPMG's request to issue a seller's permit to Lands' End. The Board's denial of KPMG's request would mean that Lands' End would continue to collect the use tax from in-state purchasers and report it on the sales and use tax returns it currently files.

An out-of-state retailer with a California office has a use tax collection obligation for sales to California customers when title to the goods transfers to the California customer *outside* this state. (Reg. 1620(1)(a).) While an out-of-state retailer with a California office may have a use tax collection obligation *or* a sales tax obligation for sales to California customers when title to the goods transfers to the California customer *inside* this state, the determination whether that sale is subject to sales tax or use tax depends upon the participation of the retailer's California office in the sale. Thus, even if title to the goods were to pass to Lands' End's customers in California, Regulation 1802(c)(1) provides:

"When the order for the property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state from a point outside this state, the transaction is subject to the local tax ordinance of the participating jurisdiction where the first functional use is made."

The regulation expressly provides that when the purchaser's order is sent directly by that purchaser to the retailer's out-of-state location and the goods are shipped to the purchaser inside the state from a point outside the state, the transaction is subject to the local *use* tax. That is precisely how the Lands' End transactions work here.

Lands' End's request for a seller's permit is based on two factors: (1) that title to the property transfers in California, so that the sale is in fact made in this state; and (2) that conducting a credit check at its Ontario location qualifies as participation in a sale, thereby subjecting Lands' End to California's requirements for collecting and remitting sales tax on orders so processed. Lands' End's request ignores the fact that its sales transactions, where the California customer sends the order for property directly to Lands' End at its out-of-state location and the property is shipped directly to the customer, fall within Regulation 1802(c)(1) and are subject to the local use tax of the place of use.

¹¹ California Uniform Commercial Code section 2319 defines the term "F.O.B." as follows:

"(1) Unless otherwise agreed the term F.O.B. (which means 'free on board') at a named place, even though used only in connection with the stated price, is a *delivery term* under which

(a) When the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this division (Section 2504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) When the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this division (Section 2503)." (Emphasis added.)

Place of Sale

With regard to the first factor, KPMG has represented that Lands' End sales take place in this state because shipments to California customers are F.O.B. destination. They have provided an affidavit signed by a company official stating that "[t]he direct-to-consumer sales of Lands' End's products are shipped 'F.O.B. destination.'" (See Exhibit 2). In response to staff inquiry as to whether Lands' End has or will have a contract with UPS and the U.S. Postal Service addressing delivery F.O.B. destination, Mr. Andal and Mr. Halverson responded that the affidavit stands on its own, and no additional documentation is required.

Regulation 1628(b)(3)(D), consistent with California Uniform Commercial Code section 2401, states:

"Unless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and the place at which the retailer completes its performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different time or place... If the contract [of sale] expressly requires *delivery* at destination, including cases where one of the terms of the contract is F.O.B. place of destination, the retailer completes his performance with reference to the physical delivery of the property on tender to the purchaser there." (*Ibid.*, emphasis added.)

Thus, under Regulation 1628 and California Commercial Code section 2401, unless the contract of sale *expressly* states that delivery is to be F.O.B. destination, the retailer completes his or her performance upon delivery of the property to the shipper for the shipper's delivery to the purchaser. Under the California Uniform Commercial Code, "F.O.B." is a delivery term. The parties' agreement to ship the goods to a specific address does not make the contract "F.O.B. destination." Specifying the location where goods are to be shipped is required whenever goods are shipped by carrier, and is insufficient to overcome the presumption that delivery occurs when the goods are transferred to the shipper for the shipper's delivery to the purchaser. (Matthew Bender (2003) "Sales and Bulk Transfers under the Uniform Commercial Code" section 8.02[1][a][i].)

Unless Lands' End can demonstrate that its agreements with its customers require it to ship its products F.O.B. destination, the general rule set forth in subdivision (b)(3)(D) of Regulation 1628 will apply. If the contract does not require Lands' End to deliver the goods at destination, Lands' End completes its performance with respect to physical delivery of the property at the time and place of shipment, which occurs when the property is handed off to UPS or the U.S. Post Office in Dodgeville, Wisconsin.

Staff notes that the foregoing analysis regarding the place of passage of title applies to transactions in other contexts. For instance, absent a contractual provision passing title earlier, if possession of a product is transferred to the purchaser or the purchaser's agent outside this state, the sale does not occur in this state. (See, e.g., Annotation 325.0410 (11/19/99)). On the other hand, if the parties contract to deliver title in another state or offshore, but in fact title or possession passes in California, the sale takes place in California.

When the delivery by common carrier is *not* F.O.B destination, the sale occurs at the time goods are transferred to the common carrier. Lands' End transfers goods to the common carrier (either UPS or U.S. Postal Service) out of state. Accordingly, Lands' End's sales take place out of state. Because the sales occur outside this state, the transactions cannot be sales tax transactions.¹² Because the sales take place outside California, the level of participation in the sales by the Ontario office is irrelevant. Regulation 1620(a)(1) explicitly states that “[i]f title to the property sold passes to the purchaser at a point outside this state, or if for any other reason the sale occurs outside this state, the sales tax does not apply, *regardless of the extent of the retailer's participation in California in relation to the transaction.* (Emphasis added.)

In summary, title to the property must transfer inside California in order for the sale to occur in this state and thereby be potentially subject to sales tax. Because Lands' End's sales to California customers take place in Dodgeville, Wisconsin, when the goods are transferred to the carriers for shipment to California customers, Lands' End's sales to California customers do not occur in California and Lands' End should not be issued a seller's permit at the Ontario location.

Participation in a Sale

Even if Lands' End established that its sales will occur in California, its activities at the Ontario location are not sufficient to establish participation in the sale. The Board has never issued seller's permits to locations where only credit check activities occur. Permits are issued to locations out of which sales are solicited, orders are taken, customer negotiations occur, or in some cases,¹³ where orders are shipped or delivered. This is the standard that distinguishes the participation in the sales transaction of an in-state retailer from the broader use tax nexus standard for an out-of-state retailer who merely has physical presence in this state for the purpose of selling tangible personal property. While Lands' End is engaged in the business of selling tangible personal property in California (RTC section 6203) and while it represents that goods are shipped F.O.B. destination (sales take place in California) from out-of-state warehouses, these facts provide the taxpayer with a use tax nexus resulting from its physical presence in California that is not sufficient to sustain sales tax nexus unless the Ontario desk is found to participate in the sales transactions. The Board has consistently viewed “participation” in sales as negotiating with customers by taking orders or by shipping or delivering property by the retailer's employees to customers in California from the retailer's in-state stock of goods (Regs. 1669, 1620, and 1802(b)(5)).¹⁴

¹² Because these transactions are not sales tax transactions, Lands' End's situation differs from that of Signal Hill, Fremont & Long Beach (a local tax reallocation case heard by the Board on 9/19/02) mentioned by interested parties as an analogous situation. In Signal Hill, Fremont & Long Beach, the cities and staff agreed there was no question that the transactions were sales tax transactions. The question addressed by the Board was the *allocation* of sales tax. The question was whether the local sales tax should be allocated directly or indirectly.

¹³ With respect to property shipped or delivered to customers from an in-state stock of goods, when the Board amended Regulations 1699 and 1802 operative October 1, 1993, to allow the issuance of a seller's permit to the warehouse location of a taxpayer who does not have another sales office in this state, the transaction was already subject to sales tax rather than use tax, and the amendments allowed the change in allocation of the local sales tax from a statewide pool to the jurisdiction where the warehouse is located. It did not convert a use tax transaction into a sales tax transaction (See also Annotation 700.0180 (4/8/65)).

¹⁴ Regulation 1802(c)(1) expressly states that when an order is sent by a California purchaser directly to the retailer's out-of-state location, and the property is sent directly to the California purchaser by the out-of-state location, such a sale is subject to use tax. The Lands' End Transactions are thus subject to use tax.

In its April 9, 2004, letter (see Exhibit 2, page 16), KPMG states that the staff's discussion of court cases is "irrelevant" and claims that there are "no *separate* constitutional standards for sales tax and use tax." (Emphasis in original.) Staff disagrees for the following reasons.

The answer to the question of when a state may levy a sales tax or when it may impose a use tax collection obligation on out-of-state retailers is found in the Commerce Clause of the U.S. Constitution, which states have interpreted in duly adopted regulations. A regulation may not be construed beyond the Constitutional limitations. When the issue is whether or not a state may levy a sales tax directly on an out-of-state retailer, the United States Supreme Court in *Tyler Pipe Industries, Inc v. Washington* (1987) 483 U.S. 232 set forth the constitutional standard as follows: "[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." (*Ibid.* at 250, citation omitted.) The seller's activities within the state must also be associated with the activity sought to be taxed. (*Natl. Geog. Soc. v. St. Bd. of Equal.* (1977) 430 U.S. 551, 560.) "However fatal to a direct tax a 'showing that particular transactions are dissociated from the local business...', such dissociation does not bar the imposition of the use-tax-collection duty." (*Ibid.*, citations omitted; See also *Norton Co. v. Dept. of Rev.* (1950) 340 U.S. 534, 537 cited in the Memorandum Opinion of Long Beach Container Terminal Inc. (11/17/94.))

These cases are precisely on point. It is undisputed that Lands' End is headquartered in Dodgeville, Wisconsin. All of its sales and major administrative functions apparently take place there. It is an Internet and mail-order direct marketer. All of Lands' End's activities regarding establishing and maintaining a market share for its goods occur outside California, in Dodgeville, Wisconsin.¹⁵ The credit check does not come into play until the sales negotiations with the customer are complete. The proposed activities in Ontario are not associated with establishing and maintaining market share for Lands' End's goods, which occurs in Wisconsin. The proposed credit check activities in Ontario may be important as additional protective measure for Lands' End's financial well being, but these activities are invisible to the customer and can take place anywhere. They have no association with negotiations Lands' End conducts with its customers in order to sell its products.

Regulation 1699(a) specifies that every person engaged in the business of selling requires a seller's permit for each place of business in this state at which transactions relating to sales are customarily negotiated with customers. In its February 18, 2004 submission, KPMG avers that neither Regulation 1699(a) nor the annotations define the word "negotiations." However, words in a regulation must be taken in their ordinary meaning, unless a more technical meaning is clear from the context. (*Johnson v. Udall* (E.D. Cal. 1968) 292 F.Supp. 738, 750.) The word "negotiate" is defined identically in a standard Webster's dictionary and in Black's Law Dictionary, as meaning "to confer with another so as to come to terms or reach an agreement." (Webster's II New Riverside University Dictionary (1994) p. 789, col. 1; Black's Law Dict. (5th ed. 1979) p. 934, col. 1; see, *Mason v. Mazel* (1947) 82 Cal. App. 2d 769, 772.)

In staff's view, an office which has no contact with any person outside Lands' End staff cannot be said to "confer with another." Thus, despite KPMG's argument that the Ontario operation would engage in "transactions relating to sales," it cannot be said that an office that does not talk to any customers would engage in "negotiations" in any common understanding of the word. Because no negotiations with

¹⁵ In its submission dated April 9, 2004, Lands' End asserts that performing a credit check is one of the listed examples of participation set forth in Regulation 1802(a)(2)(B). (Lands' End's submission is discussed below in section VI, Alternative I.) Staff asserts that Lands' End is incorrect in its understanding of what the regulation explains. The regulation merely explains that when a taxpayer has more than one place of business in this state, it is immaterial if the approval of credit is some place other than where the negotiation occurred. The regulation does not provide that merely performing a credit check constitutes local participation in and of itself.

customers take place at the Ontario location, Lands' End does not qualify for a seller's permit for that location under Regulation 1699(a).

KPMG also attempts to distinguish the fraud and bankruptcy check operation that is proposed to be performed at the Ontario location from the Board's Memorandum Opinion in *Long Beach Container Terminal* (11/17/94), by saying that the office there was temporary and merely the last step in completing a previously-negotiated sale. On the other hand, KPMG states that the Ontario office will be permanent and is necessary and integral to a sale's completion. A construction office entrenched during the course of installation is far more permanent and critical than the location of a personal computer, which is so easily moved as to be in reality temporary. (See, e.g., *Crocker Natl. Bank v. San Francisco* (1989) 49 Cal. 3d 881.) In *Long Beach*, without the installation of the cranes at issue therein, the sale would not have gone through. Here, the credit checking in this information age can be done anywhere.

In staff's opinion and based on the description of the duties to be performed by the employee at the desk in Ontario, the Ontario desk will perform the same kinds of administrative tasks that in the past were interpreted as inadequate to allow the state to impose a sales tax obligation on out-of-state retailers. The Ontario employee's responsibilities are described as facilitating electronic bankruptcy and fraud checks of the 2,400 to 5,400 daily transactions with California customers, on Sears' database, processing electronically generated credit reports and results, forwarding credit check results to the Wisconsin office, downloading program software to update the database, etc. Staff views this activity as a back-office operation, which is an administrative function that the public never sees, not a part of the sales negotiation.

The staff position is consistent with practices followed by the Board in registering taxpayers and issuing seller's permits for over 50 years. It is based on the provisions of Regulations 1620, 1699, and on opinions reflected in Annotations 325.0020 (3/3/53), 325.0080 (3/31/55), 325.0107 (5/13/77), and 495.0625 (9/18/95). Since 1939 the Board has ruled that a seller's permit can only be issued to a location at which sales are customarily negotiated with clients. Former Tax Ruling 79, the pertinent language of which is now in Regulation 1699(a), announced the same rule. "Selling" means "sales negotiations with customers" in this context. The sales tax does not recognize any other kind of business operation. A business operation that does not meet the standard of a place at which a person intends to sell tangible personal property to third parties cannot be considered, for sales tax purposes, a "place of business," that must be issued a seller's permit, while the physical presence of the office will support use tax nexus. The annotations cited by Lands' End all involve permitized locations that either take orders or facilitate the delivery of the retailer's goods pursuant to the contract of sale and do not support Lands' End's contentions.

KPMG relies upon the last sentence of subdivision (a)(2)(A) of Regulation 1620 to argue that the regulation does not define "participation." However, it does state that "[p]articipation in the transaction in any way ... is sufficient to sustain the [sales] tax." Staff believes KPMG's reliance on the last sentence in this subdivision is misplaced for two reasons. First, KPMG's interpretation is contrary to fundamental rules of regulatory construction. Read alone, the last sentence states "Participation in the transaction in any way by the local office, branch, outlet or other place of business is sufficient to sustain the tax." The first sentence of this subdivision, however, begins: "Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any local branch, office, outlet or other place of business of the retailer in this state..." KPMG's position would take the last sentence of the paragraph out of context and assign it a meaning that would bring it into direct conflict with the first sentence, which clearly requires that, for sales tax to apply, either the order must be sent to the local office or shipment or delivery of the property must be made by the local office. Sentences in sales and use tax regulations, just like sentences in sales and use tax statutes, must be interpreted in light of each

other. Words and phrases in a regulation must be construed together to bring them all into harmony and not into conflict. (*Moyer v. Workmen's Comp. Appeals Bd.* (1973) 10 Cal.3d. 222, 234.) While subdivision (a)(2)(A) requires the purchaser to send the order to the local office, in Lands' End's situation, the purchasers send their orders to Wisconsin.

Second, the Rulemaking File shows that in promulgating subdivision (a)(2)(A) of Regulation 1620, the Board incorporated the holding of *General Motors Corporation v. Washington* (1964) 377 U.S. 436, a Washington business-and-occupations-tax case. That case discussed the activities of the local office of the retailer, "particularly with relation to the establishment and maintenance of sales." (*Ibid* at 438-439.) Thus the expansive interpretation of Regulation 1620(a)(2)(A) which KPMG urges upon the Board is unwarranted by both the rules of regulatory construction and the rulemaking record. The regulations are not independent authority, but are interpretations of law, in this case, the U.S. Constitution.

KPMG's reliance on Annotation 325.0120 is also misplaced. At the Board hearing and in its April 12, 2004, submission, KPMG argued that the annotation supports sales tax nexus based on a credit check operation (if title also passed in the state). Staff disagrees. The annotation addressed only the issue of whether or not the solicitation of orders or the servicing of machines by representatives of the retailer's permitized local branch office would constitute "participation" sufficient to support the imposition of a sales tax. In its response to the issue, the Legal Department set forth a lengthy quote from a Washington Supreme Court case, *B. F. Goodrich Co. v. Washington* (1951) 231 P.2d 325.¹⁶ There, the Washington Supreme Court approved the application of Washington's Business and Occupation Tax on sales where the orders were placed directly with the seller's out-of-state sales office. If the purchaser had not previously obtained franchise and credit approval in state, the order was funneled through the appropriate division office of the retailer in Washington for credit approval and then sent on to the sales office out-of-state. (*Ibid.* at 326.) What distinguishes that case from KPMG's proposition is, first, that the division offices that did the credit checks were also engaged in extensive marketing and selling operations in the state and sold products to manufacturers and dealers. The credit checks were a small part of their overall operation, not the sum total of it. Second, the Washington statute taxed the privilege of engaging in business in the state, measured by, among other things, the value of manufactured products, gross proceeds from sales at wholesale, or gross income of the business. As the Washington Supreme Court makes clear, the sales themselves did not have to take place within the state so long as the in-state business activity "performs a service essential to the completion of the sales the proceeds of which the state seeks to tax." (*Ibid.* at 675.) The sales Washington sought to tax were directly connected to the in-state business activity of the in-state office. By contrast, the California statute levies a tax "for the privilege of selling tangible personal property at retail ... in this State." (RTC section 6051.) The business activity that takes place in this state, therefore, must be the selling of tangible personal property at retail. (RTC sections 6007, 6016(a), 6051, and 6066.) Also, unlike the Washington statute, the sales must take place in this state for the California sales tax statutes to reach them. (RTC sections 6010.5 and 6017.) All that may be included in the measure of tax, again unlike the Washington statute, is the gross receipts derived from sales of retailers. (RTC section 6012(a).) The *B.F. Goodrich* case, then, does not stand for the proposition that if the only activity in this state is a credit-check operation, California or any of its political subdivisions has the power to have an out-of-state retailer pay California sales tax. KPMG also argues that Regulation 1699 states when permits are required, but does not impose any limits regarding who *may* be issued a seller's permit. Whether or not Lands' End is entitled to a seller's permit is not a matter of its desire but a matter of law. In the case of sales tax, whether or not the retailer owes the tax is a matter of law and is not subject to contract. (See, e.g., *Perry v. Washburn* (1862) 20 Cal. 318, 350.) Thus, Lands' End cannot agree to pay a tax it does not owe. When the issue is the retailer

¹⁶ Decisions of courts of other states, of course, are not binding in California.

collecting use tax, a retailer who is not otherwise engaged in business in this state may voluntarily choose to collect the use tax on sales made to in-state purchasers by registering with the Board to do so. (Reg. 1684(c).)

As support for its position, KPMG notes that Regulation 1802 states: "...if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business..." However, this statement in the regulation is true only for transactions where the sales tax applies and the "place of business" can be issued a seller's permit under Regulation 1699. Directly on point is the provision of Regulation 1802(c)(1) which states:

"When the order for the property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state from a point outside this state, the transaction is subject to the local use tax ordinance of the participating jurisdiction where the first functional use is made."

As a rule of statutory construction, the specific prevails over the general (*Miller v. Superior Court* (1999) 21 Cal.4th 883; *Calif. Drive-In-Restaurant Assn. v. Clark* (1943) 22 C.2d 287 [rules of statutory construction generally apply to regulations]). Accordingly, the applicable tax here is the use tax as explained above (see Regulation 1802). Implied in this regulation is the determination that even if title were to pass in California, when the order is sent directly to the retailer out of state and the shipment is made from an out of state location directly to the consumer, the transaction is a use tax transaction, and any participation in California is insufficient to render it a sales tax transaction.

The California Retailer's Association supports KPMG's proposal, indicating that a seller's permit should be issued so that Lands' End may begin to collect sales tax reimbursement and pay it to the Board on its quarterly sales tax returns. Staff, however, points out that Lands' End is already collecting use tax from its customers and reporting the use tax on its quarterly sales and use tax returns. As the sales and use tax rates are identical, the same amount is reported, whether the tax is sales or use tax.

At the interested parties meeting on April 1, 2004, Mr. Albin C. Koch, representing MBIA Muni Services, Inc., made two recommendations. First he suggested that the Board should support establishing standards for the use of economic incentives by local government and help formulate what the standards might be. Staff believes his suggestion is beyond the scope of this BTC issue.

Second, Mr. Koch expressed his belief that there is a presumption that local taxes are to be allocated directly. Staff disagrees. The bulk of local use taxes are allocated indirectly, i.e., through the medium of the countywide pool system. Local sales taxes are generally allocated directly, with the biggest exceptions being so-called "special sellers" (sellers whose permits are coded SS), construction contractors¹⁷, and certain high-volume-but-low-per-unit-cost sellers. (See Compliance Policy and Procedures Manual, Chapter 5, *Returns*, Exhibit 5.)¹⁸

Interested parties' submissions in favor of the staff recommendation

Mr. David McPherson of the City of San Jose believes the local taxes that Land's End generates should continue to be allocated through the medium of the countywide pools. His main points are summarized

¹⁷ See *San Joaquin v. State Board of Equalization* (1970) 9 Cal. App. 3d. 365, 375-376.

¹⁸ Staff notes that aspects of the Streamlined Sales Tax Program (SSTP), if adopted by California in legislation, may ultimately result in a change of the local tax system to a place-of-use orientation similar to district taxes.

as follows and the full submission is attached as Exhibit 8:

- Section 7205 of the Uniform Local Sales and Use Tax Law provides that for purpose of the sales tax, all retail sales are *consummated* at the place of business of the retailer unless the property sold is delivered by the retailer to an out-of-state location. The word “consummated” in the Webster’s dictionary means “finish or complete, as a business deal.” The Lands’ End Ontario location fails to start or finish the sale of any tangible personal property with the customer since it does not negotiate the sale or process the order for the customer.
- The Ontario location does not comply with Regulation 1699 just as a computer server at which a website resides may not be issued a seller’s permit on its own merit, as supported in Annotation 710.0013.600. (See also Regulation 1699(i).)
- Regulation 1802(a)(2)(B) embraces the following key elements to determine where the sale occurs for local sales tax purposes and defines the intent and spirit of the Bradley-Burns Act. First, there must be a principal negotiation at the site. Second, it must be the place where the order is taken. Finally, it is immaterial that the order must be forwarded elsewhere for approval of credit. The Ontario location does not comply with the position that cities have supported and operated under since the Bradley-Burns Act was implemented.
- The City of San Jose will lose \$40,000 a year and the top 12 cities in the state would lose more than \$250,000 a year as a result of approving KPMG’s proposal.

Mr. Matt Hinderliter of the HdL Companies makes the following arguments in his opposition to KPMG’s proposal:

- KPMG’s contention that Board staff is denying a taxpayer the opportunity to pay tax is incorrect since Lands’ End is already required under no uncertain terms to collect use tax from California customers.
- The Board had legitimate public policy concerns and goals in drafting Regulation 1620 in a broad fashion so as to include as many out-of-state retailers as possible. This regulation was not meant to amend or replace any other regulations specifically addressing the distribution of the Uniform Local Sales and Use Tax.
- Regulation 1802(a)(2) specifically states that, if a retailer has more than one place of business, the place of sale is where the order is taken. It is immaterial that the order must be forwarded elsewhere for acceptance, *approval of credit*, shipment or billing. Mr. Hinderliter indicates that the addition of the qualifier “in this state” with respect to the location of the company’s various facilities was made in response to another specific case before the Board and it is doubtful that the Board considered at the time that this change would result in making a credit check office a place of sale.
- There is concern over the lack of restrictions concerning a retailer’s use of a seller’s permit as a tool to enter into a tax agreement with the local jurisdiction that provides the retailer with the best economic incentive to do so.

Mr. Bob Anderson of the Sonoma County Open Space Authority expressed his concern that the City of Ontario’s agreement with Lands’ End and a resulting seller’s permit would substantially impair the historic and equitable method by which the Board has administered the distribution of tax revenues under the Bradley-Burns Act for the past 48 years.

B. Pros of the Staff Recommendation

- Avoids concerns raised by some local jurisdictions regarding potential bidding contests among cities and counties in their attempt to attract locations with activities similar to Lands’ End solely for the purpose of redirecting local taxes from other jurisdictions statewide to their jurisdiction.

- Continues to allow Board staff to determine if there are misallocations on Transactions and Use (District) Taxes. This is currently done by analyzing sales and use tax returns and reconciling the local tax reported to the countywide pools with the tax reported for each Special Taxing Jurisdiction.
- Retains practices and policies followed by the Board for over 50 years.

C. Cons of the Staff Recommendation

- Continuation of current policy could hinder efforts and negate incentives offered by local jurisdictions to attract economic growth and investment to their communities, and from a broad perspective, to the State of California.

D. Statutory or Regulatory Change

No statutory or regulatory change is required.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

There will be no additional costs.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

Retains stability and predictability of revenue for cities and counties in regard to California sales by out-of-state retailers who may be situated similarly to Lands' End.

H. Critical Time Frames

None.

VI. Alternative 1

A. Description of the Alternative

KPMG proposes that the Board issue a seller's permit to the Lands' End location in the City of Ontario that will allow Lands' End to allocate the local portion of the tax to that City rather than through the medium of the countywide pools of the place of use. Conducting a credit check at its office in Ontario as a condition precedent to a California order's final approval and shipment qualifies as "participation in" a sale, thereby subjecting Lands' End to California's requirements for collecting and remitting sales tax. The local portion of the tax reported on Lands' End's California sales should be allocated to the City of Ontario because the Ontario office is Lands' End only business location in California. KPMG believes its proposal does not seek to change the law or set precedent but merely represents a request for a seller's permit for Lands' End's only California location. KPMG's submissions are attached as Exhibit 2 and include the following:

Mr. Michael D'Addio's letters of April 9 and 14, 2004 with two attachments entitled "Lands End, Inc. - Facts Regarding Ontario, California Office Operations" and "What is a FICO score?"

Mr. Rex Halverson and Mr. Dean Andal's letter of April 12 with their February 18, 2004 analysis of legal issues, and an affidavit signed by Lands' End's Chief Financial Officer.

KPMG's arguments are summarized as follows:

- Regulation 1699 states that a permit is required for each place of business "at which *transactions relating to sales* are customarily negotiated with... customers." It does not say "at which sales" are customarily negotiated. Performing fraud checks and finalizing approvals of California orders are common transactions that customarily relate to all sales transactions. There is no further guidance as to what constitutes "negotiations." The negotiations of California orders are ongoing until the Ontario office has completed its performance of a fraud check and issuance of final approval as conditions. Thus the activities undertaken at the Ontario office meet both statutory and regulatory requirements for a seller's permit. In addition, Regulation 1699 states when permits are required, but does not set any limits regarding who may be issued a seller's permit.
- Regulation 1620 does not define what constitutes "participation," however it does state that participation in the transaction *in any way*... is sufficient to sustain the sales tax. The phrase "in any way" is not limiting but rather broad and seemingly all-inclusive, which implies that an expansive interpretation be given to the meaning of "participation." Based on the activities performed at the Ontario location, the Ontario office actively participates in each California sale and makes the actual final sales decisions in the negotiating process.
- Lands' End's position is based on many Board decisions and annotations regarding "participation." Credit approval is an element of negotiating any sale and is one of the listed examples of participation contained in Regulation 1802(a)(2)(B), along with acceptance, shipment and billing. The existence of in-state "participation" was a deciding factor in the Board's decisions in *Long Beach Container Terminal, Inc.* and *The Cities of Fremont, Signal Hill and Long Beach*, as well as in many annotations listed in the submission. The *B.F. Goodrich Co. v. Washington* case in Annotation 325.0120 (4/21/52) serves as persuasive support for the assertion that credit approval by a local office is an essential part of a sale's completion and sufficient to create an obligation to register and remit sales tax.
- Lands' End has substantial in-state activity to sustain the sales tax. The credit check in Ontario represents a visible step towards market protection and development that satisfies the substantial in-state activity standard required by staff.
- The distribution of Lands' End catalogs as well as the promotion and sale of its goods by Sears, in Sears' California department stores, are activities that maintain a market in California.
- There are no separate constitutional standards for sales tax and use tax. The question presented is whether the Lands' End sales are subject to sales tax rather than use tax. That determination is made under California law only. There is no constitutional issue presented.
- Staff's argument that the Lands' End location does not qualify for a seller's permit because it has no customer contact mischaracterizes the law regarding seller's permits. Such a standard is incompatible with the staff's own views on shipments from an in-state inventory.
- For accounting purposes, a sale is recorded when all the events have occurred which fix the right to receive the income. A credit check is part of the contract of sale and the sale is not complete until

merchandise is shipped and, in the case of F.O.B. destination terms, delivered. Lands' End accounting practices reflect these principles, as sales are not recorded until three days after shipment.

Mr. Bill Dombrowski of the California Retailer's Association supports KPMG's recommendations. He states that while there is no way a traditional brick and mortar store can lawfully avoid paying sales tax to the Board, out-of-state mail order or Internet sellers have ample opportunity to avoid California sales tax payment and collection responsibility, which provides a significant competitive advantage. CRA believes that Lands' End's credit check employee participates in sales transactions involving California customers and this activity is sufficient to create nexus for sales tax purposes in Ontario. Therefore, CRS concludes Lands' End should be issued a seller's permit so that it may begin to collect sales tax reimbursement and pay it to the Board on its quarterly sales tax returns.

B. Pros of the Alternative

- The City of Ontario will experience a revenue gain as the local revenue generated by Lands' End sales shifts from other jurisdictions.
- The allocation of the sales tax to the local jurisdiction where the retailer maintains a credit office may be viewed as an incentive for economic growth by local jurisdictions that wish to enter into such agreements with retailers.

C. Cons of the Alternative

- Will result in revenue loss to cities and counties other than Ontario who will stop receiving the local use tax portion on Lands' End sales to customers residing in their local jurisdictions.
- May lead to similar requests from other out-of-state retailers who are now (or may be in the future) similarly situated, thereby fostering uncertainty in the Bradley-Burns system.
- Will make it difficult for Board staff to determine if there are misallocations of Transactions and Use taxes to Special Taxing Jurisdictions based on the returns filed by taxpayers. This is currently done by comparing the local tax reported to the countywide pools with the tax reported for each Special Taxing Jurisdiction.
- Facilitates transfer of public revenues into hands of private parties by encouraging similar revenue sharing agreements between cities and out-of-state retailers.

D. Statutory or Regulatory Change

No statutory or regulatory change is required.

E. Administrative Impact

The alternative will result in the closing of Lands' End Certificate of Registration – Use Tax and the issuance of a seller's permit for the Ontario location.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

No revenue impact is anticipated for the state portion of the total tax currently collected. However, this alternative would result in a change in future allocation of the local tax from countywide pools statewide to the City of Ontario. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

- May upset the stability and predictability of revenue for cities and counties in regard to California sales by out-of-state retailers who may be situated similarly to Lands' End.

H. Critical Time Frames

None.

Prepared by: Tax Policy Division, Sales and Use Tax Department and Legal Department

Current as of: May 12, 2004

LIST OF EXHIBITS

Exhibit

- 1 Revenue Estimate**
- 2 KPMG Submissions**
- 3 RTC Section 6203**
- 4 Regulation 1699**
- 5 Regulation 1620**
- 6 Regulation 1802**
- 7 Regulation 1628**
- 8 City of San Jose Submission**

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



BOARD OF EQUALIZATION
REVENUE ESTIMATE

**DISCUSSION REGARDING ISSUANCE OF A SELLER'S
PERMIT TO LANDS' END'S LOCATION WHERE ONLY
CREDIT CHECKS ARE PERFORMED**

Staff Recommendation

Staff recommends that the Board not issue a seller's permit to Lands' End for an Ontario location, where Lands' End plans to have an employee run secondary credit checks, for the following reasons:

- The order is sent by the purchaser directly to Lands' End at a point outside California, the property is shipped to the California purchaser from a point outside this state directly to the purchaser in California, and the activities performed by the Ontario employee do not constitute "participation in the sale."
- Sales to California customers will occur out of state when property is transferred to the U.S. Postal service or UPS (Land's End's common carriers) for delivery to California. There is no evidence of an express agreement with customers requiring delivery at destination in California such as a delivery term F.O.B. (free on board) destination.

Alternative 1

Approve Lands' End application for a seller's permit for a planned City of Ontario location on the basis that sales tax applies to their California sales for the following reasons:

- The activities of the Lands' End employee in Ontario will qualify as "participation in the sale" when such employee conducts a secondary credit check (verifying that proper reports are run in California on each batch of orders received, and analyzing the results of those reports) at Lands' End's Ontario office as a condition precedent to the final approval and shipment of a California order.
- The sale of the property occurs in California because Lands' End makes its deliveries of product on a F.O.B. destination basis.

Background, Methodology, and Assumptions

Staff Recommendation:

There is nothing in the staff recommendation that would effect revenue. Revenue collection is not at issue here. Staff's proposal would continue to allocate the local portion of the use tax where the property is first used.

Alternative 1:

There is nothing in Alternative 1 that would effect total revenue. However, Alternative 1 would require the Board to allocate Land's End's collection of tax as a local sales tax to the City of Ontario, as opposed to a local use tax to the local jurisdiction where the property purchased is first used.

Revenue Summary

The staff recommendation has no revenue effect.

The alternative proposal has no revenue effect.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative Division, and Mr. Jeffrey L. McGuire, Tax Policy Division, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of May 5, 2004

April 12, 2004

Mr. Jeffrey L. McGuire
Board of Equalization
Tax Policy Division
Sales & Use Tax Department
PO Box 942879
Sacramento, CA 94279-0092

RE: Lands' End, Inc.

Dear Mr. McGuire:

We would like to submit the two documents enclosed as part of the record related to the interested parties meeting held by the Board on April 1, 2004. The first is our white paper on the legal issues involved. The second document is the affidavit of Mr. Donald R. Hughes, Senior Vice President and Chief Financial Officer of Lands' End, who attests to the fact that all products are shipped FOB destination. The questions that you posed to Michael D'Addio will be responded to via a separate letter.

Thank you for your assistance in this matter. If you have any questions, please contact me at 916-554-1129.

Very truly yours,
KPMG LLP

Rex Halverson
Director
State & Local Tax Practice

Enclosures

s:clients/H-L/Lands_End/2004/IMcGuire041204.doc

cc: Susan Russell, *Sears*
Michael D'Addio, *KPMG – Los Angeles*
Dean Andal, *KPMG - Sacramento*

To Board Members

Date February 18, 2004

From Dean Andal and Rex Halverson

Ref

Lands' End CA Sales Tax Issue**FACTS**

Lands' End ("Lands' End" or "the Company") is a Delaware corporation headquartered in Dodgeville, Wisconsin. The Company is a direct merchant of clothing, luggage, and products for the home. Lands' End sells this merchandise worldwide, primarily through catalogs (with orders taken by mail, fax, or telephone) and over the Internet. The Internet server is in Dodgeville. All merchandise is shipped f.o.b. *destination* by common carrier from distribution centers in Wisconsin. Title and risk of loss pass to the customer upon delivery of the merchandise to its "ship-to" address. In addition to catalog and Internet sales, Lands' End operates twenty retail stores located in three countries: (1) the United States (sixteen total stores in four states—Illinois, Minnesota, New York, and Wisconsin); (2) the United Kingdom (three stores); and (3) Japan (one store).

Lands' End was acquired by Sears, Roebuck & Company ("Sears" or "Parent") in May 2002. In July 2002, Lands' End began accepting the Sears credit card in addition to the other methods of payment it previously accepted. In late 2002, Sears began distributing the Company's catalogs in its retail stores in California. Pursuant to this activity at California Sears stores, Lands' End obtained a Seller's Permit (SC OHA 100-121213) and began collecting use tax on its California sales (i.e., sales with a California ship-to address). The Company now has a permanent office in Ontario, California. This Ontario office will be the Company's only business location in California. The purpose of this office in Ontario is to perform a "credit check" and issue final approval for orders placed by California customers. No sales' negotiation is complete without final approval in the Ontario office.

Before a California order will be sent electronically to Ontario, it will be processed as any other order by being put through a series of credit checks. After a new order is received and entered into the Dodgeville system, the order is sent to a credit card processor in New Hampshire for determination that the credit card is valid. Next, the order is matched against Lands' End's fraud file in Dodgeville to verify that the credit card is not stolen. Following this step, the California order is conditionally accepted pending another credit, fraud and bankruptcy check and final approval performed at the Ontario office.¹

¹ An identical process was recently adopted for Illinois customers, with noticeable results—numerous orders that had passed through other steps of the Company's approval process were placed on hold pending follow-up with the customer.

At the Ontario office, a Lands' End employee will perform the final credit, fraud and bankruptcy check by checking the order information against Sears' proprietary fraud file. If the order passes this final credit check, it will receive approval and acceptance, thus prompting shipment of the order to the California customer. If the order fails the final credit check, it will be rejected and sent back electronically to Dodgeville for follow-up with the customer. The credit check and final approval activities will be performed for every order with a California ship-to address; California orders will not be shipped (from the Company's Wisconsin distribution centers) until the Ontario office performs a fraud check (and the check is favorable) and gives final approval.

ISSUES

1. Whether Lands' End's activities in California—conducting credit, bankruptcy and fraud checks at an office in Ontario before sales to California customers are accepted as final—triggers a sales tax obligation rather than a use tax collection responsibility for Lands' End.
2. Whether Ontario is the correct locality to which the local portion of sales tax (the Bradley-Burns Uniform Local Sales Tax) would be allocated should Lands' End be subject to sales tax on its California sales.

CONCLUSIONS

1. Conducting a fraud check at its office in Ontario, California as a condition precedent to a California order's final approval and shipment thereof should qualify as "participation in" a sale, thereby subjecting Lands' End to California's requirements for collecting and remitting sales tax on those orders so processed.
2. The Bradley-Burns Uniform Local Sales Tax for Lands' End's California sales should be allocated to Ontario because the Ontario office is Lands' End's only business location in California.

DISCUSSION

Applying for a Seller's Permit

California law requires every person engaged in business as a seller of tangible personal property to apply for and obtain a seller's permit.² The state deems a seller "engaged in business" in California if the seller has a *permanent or temporary office*, distribution center, sales room, warehouse, or other physical place of business in the state.³

California's regulations provide guidance on the number of permits California requires of a seller. Regulation 1699 states that a seller must have a permit "for each place of business in this state at which transactions relating to sales are customarily negotiated with . . . customers."⁴ The regulation illustrates when permits are needed and the number of permits required. For example, a sales office at which orders are "customarily taken and contracts negotiated," regardless of whether merchandise is stocked there, must have a permit.⁵ Another example provides that warehouses and other places where merchandise is stored, and that "customers do not customarily visit for the purpose of making purchases," do not need to have permits provided another location maintained in conjunction with the warehouse or storage facility has a permit (e.g., a sales office).⁶

Under the facts, Lands' End is a seller of tangible personal property. The question is whether California would deem the Company "engaged in business" in California, thus requiring a seller's permit. California specifically states that having a "permanent or temporary office" or a "physical place of business" in the state constitutes "engaged in business." Lands' End has a permanent office in Ontario at which it will perform fraud checks and issue final approval of California orders. The tasks the Ontario office will perform are necessary for Lands' End's California business—California orders must pass the fraud check before Ontario finalizes the order's approval. The Ontario office and the ongoing activities therein require, pursuant to California law, that the Company apply for and obtain a California seller's permit for that location. The plain language of Regulation 1699 supports the conclusion that a seller's permit is required for Land's End. The regulation states that a permit is required for each place of business in California "at which *transactions relating to sales* are customarily negotiated with . . . customers."⁷ It does not say 'at which sales' [are customarily negotiated]; it says "at which transactions relating to sales" [are customarily negotiated]. Performing fraud checks and finalizing approvals of California orders are common transactions that customarily relate to all sales negotiations. The last part of the regulation, "customarily negotiated with . . . customers," seemingly implies that negotiations with customers must take place at the location in order to obtain a seller's permit. There is no further guidance as to what constitutes

² Rev. & Tax. Code § 6066(a); Cal. Code Regs., tit. 18, § 1699(a).

³ Publication 77, "Out-of-State Sellers: Do You Need to Register with California?", California State Board of Equalization (Nov. 2001).

⁴ Cal. Code Regs., tit. 18, § 1699(a).

⁵ Cal. Code Regs., tit. 18, § 1699(a).

⁶ Cal. Code Regs., tit. 18, § 1699(a).

⁷ Cal. Code Regs., tit. 18, § 1699(a) (emphasis added.)

“negotiations.” The negotiations are ongoing until an order is finally accepted, which is evidenced by the seller’s shipment of goods pursuant to the contract. Since the Ontario office’s performance of a fraud check and issuance of final approval are conditions precedent to shipment of California orders, the negotiations of those orders are ongoing until the Ontario office has completed those tasks. Thus, the activities undertaken at the Ontario office meets both statutory and regulatory requirements for Lands’ End to obtain a seller’s permit for the location.

Imposition of Sales or Use Tax on Sales by Retail Merchants

Statutory Basis for Sales and Use Tax

California imposes a sales tax on all retailers for the privilege of selling tangible personal property at retail in California.⁸ This definition has five major components—“retailer,” “selling” (or “sale”), “tangible personal property,” “at retail,” and “in California”—that also are statutorily defined.

California defines “retailer” as a seller who makes retail sales of tangible personal property, with “retail sales” being sales other than for resale.⁹ A “sale” includes “[a]ny transfer of title . . . of tangible personal property for a consideration” and “tangible personal property” is personal property that may be seen, felt, touched, weighed, measured, or which is otherwise perceptible to the senses.¹⁰ California considers the place of sale to be the “place where the property is physically located at the time the act constituting the sale . . . takes place.”¹¹ A sale is “in California” if the place of sale, as defined above, is within the borders of the State of California.¹²

California imposes a use tax on the storage, use, or other consumption in California of tangible personal property purchased from a retailer for such purposes in a transaction not subject to sales tax.¹³ The use tax is a complementary tax to the sales tax, which applies when the place of sale is outside California, for example due to title passing upon shipment (f.o.b. shipping location) rather than upon delivery (f.o.b. destination), but the property is put to use in the state.

Regulatory Guidance on Sales and Use Tax

In addition to the statutory definitions, California has regulations that provide guidance on the applicability of sales and use tax. Under Regulation 1620, when property is shipped to a purchaser in California from outside the state, sales tax will apply providing the sale occurs in California (i.e., title to the property passes to the purchaser in California) and the retailer has a local office (i.e., an office in California) that participates in the transaction.¹⁴ Examples of “participation” by the local

⁸ Rev. & Tax. Code § 6051.

⁹ Rev. & Tax. Code §§ 6015 (defining “retailer”) and 6007 (defining “retail sale”).

¹⁰ Rev. & Tax. Code §§ 6006 (defining “sale”) and 6016 (defining “tangible personal property”).

¹¹ Rev. & Tax. Code § 6010.5.

¹² Rev. & Tax. Code § 6017.

¹³ Rev. & Tax. Code § 6201.

¹⁴ Cal. Code Regs., tit. 18, § 1620(a)(2)(A).

office include receipt of the purchaser's order at that office and delivery of the property by that office.¹⁵ However, Regulation 1620 states that participation in the transaction "in any way by the local office . . . is sufficient to sustain the [sales] tax."¹⁶ Alternatively, Regulation 1620 states that sales tax does not apply when a California purchaser sends an order directly to a retailer outside California and the property is shipped directly to the purchaser from a point outside California, "provided that there is no participation whatever in the transaction by any local . . . office."¹⁷

Regarding use tax, Regulation 1620 states that property delivered outside California to a purchaser known by the retailer to be a California resident will be deemed to have been purchased for use in California (and thus subject to use tax) unless the purchaser provides a written statement to the contrary.¹⁸ Additionally, California deems property purchased outside the state that is brought into California to have been purchased for use in California if the first functional use of the property is in the state.¹⁹ The regulation defines "first functional use" as "use for the purposes for which the property was designed."²⁰

Applicability of Sales or Use Tax to Lands' End's California Orders

As defined above, a sale is deemed to take place upon title to the property passing to the purchaser.²¹ For sales tax to apply to the transaction, the passing of title (and thus the sale) must occur in California.²² Additionally, if the property is being shipped from outside California, not only must the sale occur in the state, the seller's California office must participate in the transaction for sales tax to apply.²³

Lands' End ships all merchandise f.o.b. destination. Therefore, title to the merchandise does not pass to the customer until delivered to the ship-to address. Under this arrangement, all sales of merchandise delivered to California occur in California. However, because the merchandise is shipped from outside the state (from the Wisconsin distribution centers), under Regulation 1620, Lands' End's California office must *participate* in the transaction for sales tax to apply.

Regulation 1620 does not define what constitutes "participation," however it does state that "[p]articipation in the transaction *in any way* . . . is sufficient to sustain the [sales] tax."²⁴ The phrase "in any way" is not limiting but rather broad and seemingly all-inclusive, which implies that an expansive interpretation be given to the meaning of "participation". Earlier discussion with SBE

¹⁵ Cal. Code Regs., tit. 18, § 1620(a)(2)(A).

¹⁶ Cal. Code Regs., tit. 18, § 1620(a)(2)(A).

¹⁷ Cal. Code Regs., tit. 18, § 1620(a)(2)(B).

¹⁸ Cal. Code Regs., tit. 18, § 1620(b)(3).

¹⁹ Cal. Code Regs., tit. 18, § 1620(b)(3).

²⁰ Cal. Code Regs., tit. 18, § 1620(b)(3).

²¹ Rev. & Tax. Code § 6006.

²² Rev. & Tax. Code § 6051.

²³ Cal. Code Regs., tit. 18, § 1620(a)(2).

²⁴ Cal. Code Regs., tit. 18, § 1620(a)(2)(A) (emphasis added).

legal staff erroneously equated the Land's End factual situation with Long Beach Container. In *Long Beach Container Terminal Inc.*,²⁵ the SBE found that an Italian corporation's establishment of a temporary California construction site to install property at the customer's Long Beach location, the contract for which was entered into prior to the temporary site's establishment, was insufficient to create sales tax nexus for the Italian corporation in California. In reaching this conclusion, it appears that the SBE viewed the sale as complete (i.e., negotiated and final) and the installation as merely the last step in fulfilling that previously negotiated sale. In addition to the California site being temporary, the facts reveal that the site was established solely to install the purchased property and it was located on real property controlled by the customer.

The fraud and bankruptcy check that is performed at the Ontario office is easily distinguished from the Long Beach Container facts. The Ontario office is a permanent office. Lands' End will have a seller's permit, and the activities at that office are integral to and necessary for a sale's completion—until the Ontario office provides final approval of a California order, the sale is not complete. Unlike the activities in *Long Beach Container*, the Ontario office is not merely aiding in the fulfillment of a sales contract, but rather actively participating in each California sale and making the actual final sales' decision in the negotiation process.

In contrast to the SBE's *Long Beach Container* decision, the SBE legal staff has determined that repair activities subsequent to the sale and delivery of goods were sufficient "participation" for the taxpayer to have sales tax nexus in California.²⁶ In Sales and Use Tax Annotation 325.0120, the SBE legal staff found that servicing machines after delivery by representatives from the local office constitutes "participation" sufficient to subject the transaction to sales tax, even though the actual order was sent directly to the seller at a point outside California. This SBE legal opinion indicates that it is not necessary for "participation" to occur while a sale is still being negotiated or prior to the sale being completed. To reconcile this decision with *Long Beach Container*, there must be a certain level of participation for the SBE to determine that a transaction is subject to sales tax rather than use tax. Setting up a temporary site for the installation of equipment pursuant to one sale or for one purchaser is not sufficient participation by an out-of-state seller; having a local office, presumably permanent, from which machines are serviced by the seller's representatives is sufficient participation, even though that participation occurs subsequent to the sales. While Lands' End's activities at its Ontario office will not be exactly like the activities in either of these scenarios, the Company's facts are virtually identical to those in Annotation 325.0120: Lands' End has a permanent office, with employees who perform the specific tasks for which the office will be established, namely conducting fraud checks for all California orders and providing final approval for those sales.

Annotation 325.0120 references *B.F. Goodrich Co. v. Washington*²⁷ and has been on the books since 1952; thus, it has represented the SBE's legal position for over fifty years. At issue in *B.F. Goodrich* were business and occupation tax assessments levied by the state of Washington against

²⁵ SBE Memo. Opinion, 1994 Cal. Tax LEXIS 480 (Nov. 17, 1994).

²⁶ Business Taxes Law Guide Annotation 325.0120 (Apr. 21, 1952).

²⁷ *B.F. Goodrich Co. v. Wash.* (1951) 38 Wn.2d 663 [231 P.2d 325].

The B.F. Goodrich Company (“B.F. Goodrich”). B.F. Goodrich was a New York corporation qualified to do business in Washington and the manufacturer and wholesaler of various products. B.F. Goodrich did not engage in manufacturing within the state, but it did have numerous sales offices and employees in Washington. Of particular interest to the Lands’ End matter are the sales labeled “class C sales” and discussed by the *B.F. Goodrich* court.

Class C sales were made by B.F. Goodrich’s Tire Replacement Sales and Industrial and General Products Divisions. Within Washington, both divisions had employees, operated offices, and maintained a warehouse of inventory.²⁸ Orders for merchandise that was not available in Washington were sent directly by the Washington customer to B.F. Goodrich’s Portland office. If the customer had previously obtained credit approval for such merchandise from the proper Washington division office, and Portland had notice of such approval, the orders were accepted and filled in Portland.²⁹ However, if no such approval had been granted, the orders were referred to the Washington division office for approval. If the Washington office granted credit approval, the merchandise was shipped directly to the Washington customer from the Portland office f.o.b. Portland.³⁰

The facts involving B.F. Goodrich’s class C sales are virtually identical to Lands’ End’s situation involving its Ontario office: orders for merchandise are sent directly by California customers to Lands’ End’s Dodgeville, Wisconsin office; California orders will be referred to the Ontario office for credit approval (fraud check); if the orders pass the fraud check and are granted final approval, the merchandise will be shipped directly to the California customers from the Wisconsin distribution centers. The only differences between the *B.F. Goodrich* case and Lands’ End’s situation are that all of Lands’ End’s orders go to its Dodgeville office, all California orders will go to its Ontario office for fraud check and final approval, and all merchandise is shipped f.o.b. destination.

These modest differences are not substantive. Regarding the credit approval involved with class C sales, the *B.F. Goodrich* court stated, “[T]he Washington office unquestionably performs a service essential to the completion of the sales the proceeds of which the state seeks to tax.”³¹ Having found such, the court held “that this [credit approval] activity is sufficient to tie the class C sales to the Washington business of The B.F. Goodrich Company, and that Washington may consequently reach the proceeds therefrom through this [business and occupation] tax.”³²

The *B.F. Goodrich* decision has been annotated for over fifty years and is persuasive support for the assertion that credit approval by a local office is an essential part to a sale’s completion and sufficient to create an obligation to register and remit sales tax.

²⁸ *B.F. Goodrich*, 38 Wn.2d at 665 [231 P.2d at 326].

²⁹ *Id.*

³⁰ *Id.*

³¹ *B.F. Goodrich*, 38 Wn.2d at 675 [231 P.2d at 331].

³² *Id.*

Allocation of the Bradley-Burns Uniform Local Sales Tax on Sales by Retail Merchants*Statutory Basis for and Regulatory Guidance on the Bradley-Burns Uniform Local Sales Tax*

Under California law, counties may impose a sales tax on all retailers in the county for the privilege of selling tangible personal property at retail in the county.³³ Regulation 1803 states, “in any case in which state sales tax is applicable, state-administered Bradley-Burns uniform local sales tax is also applicable, if the place of sale is in a county imposing [such tax].”³⁴ This local sales tax is commonly referred to as the “Bradley-Burns tax,” so named after the statute’s authors.

For purposes of the Bradley-Burns tax, all retail sales are deemed completed at the retailer’s place of business unless the retailer delivers the sold merchandise to an out-of-state destination or to a common carrier for delivery outside California.³⁵ If a retailer has no permanent place of business in California, or if the retailer has more than one place of business in the state, where the retail sales are completed is determined pursuant to rules and regulations adopted by the SBE.³⁶

If a retailer has only one place of business in California, all of the retailer’s California retail sales in which that place of business participates are deemed to occur at that place of business.³⁷ As with the state sales tax discussed above, the retailer’s local office must participate in the sale for local sales tax to apply to the transaction. For the state sales tax, this means the retailer’s California office must participate in the sale; for allocation of the Bradley-Burns tax, the office located in the county to which local sales tax is being allocated must participate in the sale.

The SBE has previously opined on what constitutes a “place of business” for Bradley-Burns tax purposes.³⁸ In Annotation 710.0024, the Board stated that, to “constitute a ‘place of business,’ the retailer’s location must be a permanent office, must have a seller’s permit issued to that address, and must have personnel negotiating sales assigned there on a permanent basis.”

As with state sales tax, what constitutes “participation” is not defined in the Bradley-Burns tax statutes or regulations. However, since local tax follows the state tax, and if the sales at issue are subject to state sales tax, they are subject to local sales tax, Regulation 1620 and the analysis above regarding “participation” applies to the Bradley-Burns tax as well. The SBE legal staff’s finding as to whether the Ontario office’s activities constitute “participation” and are sufficient to subject the transactions to sales tax apply both for state sales tax purposes and the Bradley-Burns tax.

If a retailer has more than one place of business in California, but only one place of business participates in the sale, the sale occurs at that place of business.³⁹ However, pursuant to Regulation

³³ Rev. & Tax. Code § 7202.

³⁴ Cal. Code Regs., tit. 18, § 1803(a)(1).

³⁵ Rev. & Tax. Code § 7205(a).

³⁶ Rev. & Tax. Code § 7205(b)(1).

³⁷ Cal. Code Regs., tit. 18, § 1802(a)(1).

³⁸ Business Taxes Law Guide Annotation 710.0024 (Aug. 5, 1983).

³⁹ Cal. Code Regs., tit. 18, § 1802(a)(2)(A).

1802, if a retailer has more than one place of business in California that participates in the sale, the sale occurs at the place of business “where the principal negotiations are carried on.”⁴⁰ The regulation does not define “principal negotiations,” but it does state:

If this place is the place where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing. For the purposes of this regulation, an employee’s activities will be attributed to the place of business out of which he or she works.

By stating such, the regulation implies that where the order is taken is the primary factor for determining where the principal negotiations take place. Thus, providing the order is taken in California, the place of business that takes the order should be deemed to be the place of business where the principal negotiations are carried on, regardless of whether the order is sent to another location for acceptance, credit approval, shipment, or billing. Further, having been deemed the place of business where the principal negotiations are carried on, the Bradley-Burns tax should be allocated to that location under Regulations 1802 and 1803.

However, the SBE has reached a different conclusion in interpreting the relation of “place of business,” “principal negotiations,” and the applicability of the Bradley-Burns tax.⁴¹ Annotation 715.0518 involved a subsidiary that negotiated contracts outside California for fuel to sell to its parent in California. The subsidiary’s presence in California consisted of agents, who were employees of the parent and located at the parent’s California office. For this situation, the Board held:

It would not matter whether the principal negotiations for the sales occurred out of state, as long as some activity related to sales is attributed to the California office. Since that California office would be its sole place of business in California, all sales for Bradley-Burns and district tax purposes would be considered to have occurred in that county and not in the county of delivery.⁴²

As long as some activity relating to the sales is connected to the seller’s California office, the Bradley-Burns tax should be allocated to the county in which the office is located, even though the sales contracts are negotiated outside California.

⁴⁰ Cal. Code Regs., tit. 18, § 1802(a)(2)(B); *see also* Uniform Local Sales and Use Tax Annotation 710.0030 (Apr. 13, 1977) (“Under Regulation 1802 if a retailer has more than one place of business in this state, the place of sale for local tax purposes is the retailer’s place of business in this state where the principal negotiations take place.”).

⁴¹ See Business Taxes Law Guide Annotation 715.0518 (Apr. 14, 1989; amended Feb. 2002).

⁴² Business Taxes Law Guide Annotation 715.0518 (Apr. 14, 1989; amended Feb. 2002).

Allocation of the Bradley-Burns Uniform Local Sales Tax for Lands' End's California Orders

As stated above, for purposes of the Bradley-Burns tax, all retail sales of merchandise within California (i.e., where the merchandise is delivered in California) are deemed completed at the retailer's place of business.⁴³ Pursuant to the SBE's holding in Annotation 710.0024, for a retailer's California location to constitute a "place of business," three criteria must be met: (1) the retailer's location must be a permanent office; (2) the retailer must have a seller's permit issued to that address; and (3) the retailer must have personnel negotiating sales assigned there on a permanent basis.⁴⁴ Lands' End will satisfy the first two requirements because its Ontario location is a permanent office and the Company will have a seller's permit for that office. Additionally, Lands' End will have permanent employees at the Ontario office who will be responsible for performing the fraud checks and providing final approval for all California orders. The annotation does not state what constitutes "negotiating sales" within its context. Since Lands' End's California orders are not complete until the merchandise is delivered, and the orders cannot be shipped until the Ontario office has performed the fraud and bankruptcy check and issued final approval, these sales are still in the negotiation stage. The permanent employees at the Ontario office are participating in negotiating the sales. Thus, the third requirement is met and the Ontario location may constitute a "place of business." However, another SBE legal opinion addressing "place of business" and the negotiation of sales, the facts of which are similar to Lands' End's case, reached a different conclusion than that in Annotation 710.0024.⁴⁵ Annotation 715.0518 involved a subsidiary that negotiated contracts outside California for fuel to sell to its parent in California. The subsidiary's presence in California consisted of agents, who were employees of the parent and located at the parent's California office. Similar to these facts, Lands' End is a subsidiary that may be deemed to negotiate contracts outside California because all of its orders are received at its Dodgeville, Wisconsin location. Land's End may use an agent, who is an employee of its parent and is located at Sears' Ontario, California office. Presently, Lands' End anticipates that the Ontario office will be its only office in California.

In Annotation 715.0518, the SBE legal staff found that it did not matter that principal negotiations for the sales occurred outside California. As long as some activity related to sales is attributed to the California office, and providing that California office would be the subsidiary's sole place of business in the state, all sales for Bradley-Burns tax purposes would be considered to have occurred in the county where the California office was located.⁴⁶ Under this opinion, as long as some activity relating to Lands' End's California sales is connected to the Ontario office, the Bradley-Burns tax should be allocated to the county in which the office is located, even though the sales contracts may be deemed to have been negotiated outside California. The annotation does not provide what constitutes "some activity related to sales." The fraud check and final approval by Lands' End at its Ontario office are integral and essential to the negotiation process of its California sales because

⁴³ Rev. & Tax. Code § 7205(a).

⁴⁴ Business Taxes Law Guide Annotation 710.0024 (Aug. 5, 1983).

⁴⁵ See ⁴⁵ Business Taxes Law Guide Annotation 715.0518 (Apr. 14, 1989; amended Feb. 2002).

⁴⁶ ⁴⁶ Business Taxes Law Guide Annotation 715.0518 (Apr. 14, 1989; amended Feb. 2002).

those activities are required before a sales order will be completed, i.e., before the merchandise will be shipped.

CONCLUSIONS

Conducting a fraud and bankruptcy check at its office in Ontario, California as a condition precedent to a California order's final approval and shipment thereof qualifies as "participation in" a sale, thereby subjecting Lands' End to California's requirements for collecting and remitting sales tax rather than use tax on those orders so processed. The Bradley-Burns Uniform Local Sales Tax for Lands' End's California sales should be allocated to Ontario because the Ontario office is Lands' End's only business location in California.

355 South Grand Avenue
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Los Angeles, CA 90071-1568

Telephone 213 972 4000
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April 9, 2004

Mr. Jeffrey L. McGuire
Tax Policy Division
Sales And Use Tax Department
State Board of Equalization
450 N Street
P. O. Box 942879
Sacramento, California 94279-0092

Dear Mr. McGuire:

The Board of Equalization Legal Staffs Discussion Paper entitled "Issuance of Seller's Permits to Locations Where Only Credit Checks or Similar Activities are Performed" mischaracterizes the law and proposes unnecessary amendments to the California Code of Regulations. No such amendments are required. Staff's recommendation to amend Regulation 1620¹ is breathtaking in its sweep to remove the plain language contained therein that has differentiated sales tax from use tax transactions for over 50 years.

Proposed "Substantial in-state activity" Standard

Staff states that Regulation 1620 should be amended to provide that a seller's permit can only be issued if the seller has "substantial in-state activity developing and maintaining the market for in-state sales; or shipment or delivery of goods to in-state purchasers facilitated by an in-state sales office or from an in-state stock of goods." Staffs proposal would remove the reasonably clear words "participation in the transaction in any way" in favor of an ambiguous new standard that could cause sales tax currently allocated to cities to be reallocated to county pools in the future. Other unforeseen and significant reallocations also could arise. Changes of this nature and magnitude should only be made by the - Legislature.

The amendment proposed by Staff would have no effect on Lands' End. Its proposed activity in California is "substantial." Proper credit checks are very important. Controls on the extension of credit can provide a competitive edge, especially given high rates of consumer debt and bankruptcy. Without such, Lands' End exposes itself to unnecessary risk and may be unable, in a profitable manner, to further develop and maintain its marketing efforts in California.

The credit check that all orders will be subject to in Ontario provides a further, state of the art, assurance that the customer will pay for the ordered goods. When the Ontario employee determines the customer is credit-worthy, that employee directs the distribution center in Dodgeville to ship the merchandise. It is the final step to releasing the order for fulfillment. If the customer "fails" the credit check in Ontario, the order is stopped and sent back to Dodgeville, Wisconsin to either notify the customer the goods won't be shipped or solicit an alternative means of payment. Thus, Lands' End's proposed activity within California is "substantial" and represents a visible step towards market protection and development that satisfies the Staffs proposed standard.

¹ Cal. CodeRegs. tit. 18, § 1620.

Mr. Jeffrey L. McGuire
State Board of Equalization
Page 2
April 9, 2004

Furthermore, the distribution of Lands' End catalogs, as well as the promotion and sale of Lands' End goods by Sears, in Sears' California department stores are activities that maintain a market in California. Misguided Attempt to Rely on Constitutional Nexus Standards

In addition to proposing non-beneficial amendments to the regulations, the Discussion Paper mischaracterizes the relevance of the nexus discussion in *Tyler Pipe Industries, Inc. v. Wash. State Dept. of Revenue*² and other cases cited by staff. Nexus is acknowledged. This discussion is irrelevant and its inclusion demonstrates Staff's lack of a cogent argument. It appears that the Staff has searched for cases with wording that Staff "cherry-picks" to formulate into a standard to be applied in issuing a California seller's permit. There are no separate constitutional standards for sales tax and use tax. The question presented is whether the Lands' End sales are subject to sales tax rather than use tax. That determination is made under California law only. There is no constitutional issue presented.

In the *Long Beach Container Terminal, Inc*³ case, the Board held that the standards for finding that California sales tax applies are derived from the U.S. Supreme Court's decision in *Norton Co. v Illinois Department of Revenue*⁴ and that a) the sale must occur in California and b) a California office must participate in the sale.

Revenue and Tax Code section 6066 and Regulation 1699

The Staff's Discussion Paper, at page 10, mischaracterizes the law regarding sellers' permits. First, without any basis in law, the Discussion Paper claims that a credit-check operation that has "no customer contact cannot qualify as the kind of business office necessary to establish jurisdiction on the part of a state to levy a tax on an out-of-state retailer's exercise of its privilege of selling tangible personal property." This novel standard fabricated by Staff has never been used by the Board of Equalization. Such a standard also is incompatible with the Staff's own views on shipment from an in-state inventory. Warehouse employees who load goods onto trucks for delivery have no customer contact.

Second, the Discussion Paper proceeds to incorrectly describe the law regarding the issuance of a Seller's Permit. The Discussion Paper states that a "seller's permit can only be issued to a location at which sales are customarily negotiated with clients" (emphasis added). The citation regarding this statement is to Regulation 1699.⁵ Regulation 1699 states that "[e]very person engaged in the business of selling ...tangible personal property of a kind [subject to sales tax], and only a person actively so engaged, is required to hold a permit,...." The regulation states when permits are required, but does not state any limits regarding to whom a permit may be issued. The regulation requires that certain persons obtain a permit. The regulation does not restrict others from obtaining a seller's permit. Therefore, permits may be issued at the Board's discretion.

² (1987) 483 U.S. 232.

³ Bd. Memo. Op. (11/17/94).

⁴ (1951) 340 U.S. 534.

⁵ Cal. Code Regs., tit. 18, § 1699.

Mr. Jeffrey L. McGuire
State Board of Equalization
Page 3
April 9, 2004

The Discussion Paper cites California Revenue and Taxation Code section 6066 and includes quotations regarding the definition of a “place of business.” However, upon review of section 6066, the quoted language was not found. Section 6066 does not even address the definition of “place of business.” These portions of the Discussion Paper add to the lack of credibility of Staff’s arguments.

Lands' End's Position is Based on Many Board Decisions and Annotations Regarding "Participation"

Lands' End will maintain an office with an employee in California; its only business location in the state. The sole activity to be conducted there is sales order credit approval. Regulation 1802⁶ states that “ ... if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business”

A purchaser’s desire to purchase on credit and a seller’s evaluation and acceptance/rejection of credit is an element of negotiating any sale. Thus, credit approval is an element of “participation” in the sale. “Credit approval” is even one of the listed examples of participation contained in Regulation 1802(a)(2)(B), along with acceptance, shipment and billing.

Lands' End's position accords with multiple annotations and will not require any regulatory amendments. Staff's proposal to remove the concept of “participation in sales” from Regulation 1620 is ill advised. This concept has been acknowledged, relied upon by California retailers and applied by the Board and staff for over fifty years. Regulation 1802 uses the term extensively. This Regulation was just amended less than six months ago to further elaborate on the use of the term therein. Now, the Board's staff proposes to entirely remove the term from Regulation 1620, a key definitional administrative rule in California's sales tax law.

“Participation” must mean *something*. The existence of in-state “participation” was a deciding factor in Business Taxes Law Guide Annotations 325.0011.450,⁷ 325.0020,⁸ 325;0080,⁹ 325.0088,¹⁰ 325.0106,¹¹ 325.0120,¹² 710.0011.500,¹³ 710.0019¹⁴ and 715.0580¹⁵ and in the Board’s decisions in *Long Beach Container Terminal, Inc.*¹⁶ and *The Cities of Fremont, Signal Hill and Long Beach.*¹⁷ In *Fremont, Signal*

⁶ Cal. Code Regs. tit. 18, § 1802.

⁷ (8/1/89).

⁸ (3/3/53).

⁹ (3/31/55).

¹⁰ (9/18/95).

¹¹ (5/20/94).

¹² (4/21/52).

¹³ (8/11/89).

¹⁴ (3/23/95).

¹⁵ (11/16/64).

¹⁶ Bd. Memo. Op. (11/17/94).

¹⁷ Case ID 172019 (9/19/02).

Mr. Jeffrey L. McGuire
State Board of Equalization
Page 4
April 9, 2004

Hill and Long Beach, the only in-state activity was shipment and the location where that occurred was where local tax was allocated by the Board.

These annotations and decisions, in following the regulatory scheme, treat participation by a local office as causing the sales tax to apply. Additionally, the degree of participation required is not significant as evidenced by Regulations 1620(a)(2)(A) and (B)'s description of participation in such broad terms (i.e., "participation... in any way" and "provided there is no participation whatever"). Participation is, and has been, the standard for many years. To change Regulation 1620 as proposed by the Staff would go against years of law and create inconsistencies in the tax regulations and administration thereof.

Accounting Treatment

A sale is recorded for accounting purposes when all the events have occurred which fix the right to receive the income. This is referred to as the "all events" test. When all the events have occurred, a sale is recorded, notwithstanding post-sale subsequent events such as returns, warranty claims and repairs.

A contract of sale does not exist until credit is approved and accepted. A sale is not complete until merchandise is shipped and, in the case of f.o.b. destination terms, delivered. Lands' End's accounting practices reflect these principles, as sales are not recorded until three days after shipment, the average time that merchandise is in-transit to its customer. The broad, "participation in any way" language of Regulation 1620 can only mean that any sales-related human activity of the seller up until the point at which the sale is complete constitutes such participation. If that occurs in California, along with title transfer, then California sales tax applies.

* * * * *

To be clear, Lands' End is not seeking to change the law or set precedent. It simply requests a seller's permit for its only California location, an office where an employee will approve or reject credit sales. The Board's staff refuses to issue a permit-but to justify its action, it seeks to change the law and risk significantly disrupting the state's current local tax allocation system.

Very truly yours,

KPMG LLP

Michael R. D' Addio
Managing Director

April 14, 2004

Mr. Jeffrey L. McGuire
Tax Policy Division
Sales and Use Tax Department
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0092

**RE LANDS' END INC.
PERMIT NO. SC OHA 100-121213**

Dear Mr. McGuire:

We appreciate the opportunity to respond to your questions regarding the issuance of a seller's permit to Lands' End. We feel that a detailed understanding and analysis of Lands' End's facts will lead to the conclusion that Lands' End should be issued a seller's permit. So that the Board, the Legal Division, and interested parties can perform a thorough examination of the facts, as they have been restated and can be found on the enclosed document.

The remainder of this letter is devoted to responding to the questions posed in your letter to me dated April 7, 2004. The following responses are based on the facts as contained in the above-described statement of facts.

Question 1 Purpose of Ontario Credit Check

Before being forwarded for approval at the Ontario office, it is true that Lands' End orders undergo two separate credit checks: one in New Hampshire and one in Wisconsin. The function of the New Hampshire credit check is to verify that the credit card against which the order is placed was validly issued. The function of the Wisconsin credit check is to verify that the credit card against which the order was placed was not stolen. The Ontario office then performs a third credit check against a Sears Fraud File. The Sears fraud file contains FICO score and bankruptcy filing data. Thus, the Ontario credit check will serve as an additional protective measure by performing a check of California customers' FICO scores and verifying that each customer has not recently filed for bankruptcy. This check is performed because low FICO scores and recent bankruptcy filings may be indicative of a customer's inability to pay.

Question 2 Final Acceptance by Ontario Office

Once orders are received and after the initial out-of-state credit checks are performed, a batch of orders will be electronically sent to the Ontario office. Once received, the batch of orders will be compared to the Sears Fraud File, as described above. The comparison of the data in the batch of orders against the data in the Sears Fraud File is performed electronically - on the computer in the Ontario office. After the electronic comparison is made, a report is generated and reviewed by the employee in the Ontario office. Based on the report generated from the Ontario credit check, the orders are generally either approved or returned to Wisconsin for further inquiry. If the order is approved, it is sent directly to an out of state distribution center to be filled. If the order is sent to Dodgeville for further inquiry, such inquiry is made by customer service representatives at the Wisconsin location. If there is no clear result from the Ontario credit check (i.e., the result of the Ontario credit check is ambiguous), the Ontario employee will communicate with the Wisconsin office via telephone or e-mail to decide how to proceed.

The information provided by the customer when the order is placed is sufficient to perform the above-described credit and fraud checks, so the Ontario employee has no need to contact the customer and gather additional information.

Question 3 - Responsibilities of the Ontario Employee

As described above, one of the main responsibilities of the employee in the Ontario office will be to verify that the proper reports are run on each batch of orders received. After the reports are run on a batch of orders, the Ontario employee will be responsible for analyzing the results and issuing final acceptance and releasing the order to be filled by the distribution center or returning the order to the customer service center for further inquiry. Additionally, the Ontario employee will be responsible for keeping the database updated (by downloading monthly updates to the Sears Fraud File), making sure the office equipment is functioning properly, and maintaining records of each transaction processed. Thus, the Ontario employee will perform data processing tasks, manual review of reports run on batches of orders, and various other tasks.

Question 4 - Details of Order Processing

As described above, the Ontario office will receive batches of orders from California customers. Batches of orders will be received daily. The Ontario office will run its credit checks on each batch of orders. The employee does not review each order manually. All orders with California ship-to addresses are processed at the Ontario office - then the

report on each batch is reviewed by the employee and processed in accordance with the responses above-

Question 5 - Average Number of Orders Expected to be Processed at Ontario

Lands' End anticipates that 2,400 to 5,400 orders will be processed daily at the Ontario office.

Question 6 - Failure of Orders at Ontario Office

If an order is rejected as a result of the credit check at the Ontario office, the Ontario employee communicates such (via e-mail or telephone) to the Lands' End customer service center in Dodgeville so that the issue can be resolved.

The processing of some orders, however, provides ambiguous results. When this occurs, the Ontario employee will either phone or e-mail the customer service center to decide how to resolve the ambiguity.

Question 7 - Documentation and Proof that Orders are Sent FOB Destination

Lands' End's practice has always been to bear the risk of loss and transfer title upon delivery to its customer. This is supported by the sworn affidavit of Mr. Donald R. Hughes, Lands' End Chief Financial Officer, and dated June 5, 2003. A copy of this affidavit has previously been provided.

Recent Developments

Although we deem it unnecessary to the resolution of the present situation, we want to advise you that Lands' End recently has decided to further expand its presence in California. Lands' End has decided to make its California presence more substantial by placing Lands' End merchandise displays and signage, distributing catalogs, and allowing for returns at the new Ontario location. Finally, Lands' End also plans to include on its Internet website a statement that orders from California residents will be subject to a credit review in Ontario.

We hope that the attached statement of facts and above-provided answers aid in your understanding of Lands' End's facts. Should you have any question regarding the contents of this letter or the attached documents, please feel free to contact me at (213) 955-8458 or Rex Halverson at (916) 554-1129.

Very truly yours,

KPMG LLP

Michael R. D' Addio
Managing Director

cc Rex Halverson--KPMG Sacramento
Susan Russell-Sears Roebuck & Co.

Enclosure

Lands' End, Inc.
Facts Regarding Ontario, California Office Operations

Lands' End (LE) is a nationwide catalog retailer headquartered in Dodgeville, Wisconsin. In California, LE currently offers its merchandise for sale through catalogs mailed to California residents and receives customer orders in Dodgeville by telephone, mail, facsimile, or over the Internet. Lands' End was recently acquired by Sears, Roebuck & Company ("Sears") and began accepting Sears credit cards in July of 2002. In late 2002, Sears began distributing Lands' End catalogs in its retail stores in California. As a result of these activities at Sears stores in California, LE obtained a Seller's Permit (#SC OHA 100-121213) and has been collecting use tax. All merchandise is shipped, by common carrier, from distribution centers in Wisconsin, f.o.b. destination.

Lands' End now plans to open a customer service office on the premises of a Sears retail outlet located in Ontario, California. Sears also operates a large distribution center in Ontario. This will be LE's only business location in California. Telephone, mail, facsimile and Internet orders received and conditionally-approved out-of-state, will be subjected to a final credit review at this location before a customer's order is approved and shipped from out-of-state by common carrier. An employee of the company (or of Sears, acting as agent) will perform this final approval at the Ontario office.

The current processing of orders begins when customer service specialists in Dodgeville receive and enter new orders from the company's catalog and Internet customers into the company's mainframe computer located in Dodgeville. The orders are electronically transmitted to a credit card processor in New Hampshire for initial credit authorization. The test determines that a credit card is valid. Next, the orders are matched against Lands' End's "fraud file". This review, performed in Dodgeville, primarily verifies that a credit card is not stolen.

The addition of a customer service office in Ontario, California, will provide an additional step before an order is unconditionally accepted and sent to a distribution center to be filled. This additional step capitalizes upon Sears' extensive credit knowledge and best practices by requiring that each order with a California ship-to address be subjected to a final credit screening. This final screening will be against a Sears Fraud File. The Sears Fraud File is comprised of FICO score (description attached) and bankruptcy filing databases. This process has already been implemented in Illinois (Sears home state) and has resulted in various orders being "bounced" out as unacceptable credit risks.

Orders will be electronically sent to the Ontario office daily, in batches. It is estimated that each daily batch total will be comprised of 2,400 to 5,400 orders. Each batch is then electronically compared against the most recent Sears Fraud File. The electronic comparison will result in the generation of a report. The report will detail which orders "pass" and which orders "fail." Additionally, the report will generate ambiguous results on some orders. If an order receives a "pass", it will be sent by the Ontario employee directly to LE's distribution center to be filled. If an order receives a "fail", it will be sent

to "the Dodgeville customer service center for follow up. Finally, if the results of the Ontario credit check are ambiguous, the Ontario employee will contact the customer service center to obtain guidance. Communications between the various locations will be either electronically or telephonically.

In addition to verifying that the proper reports are run on each batch of orders and analyzing the reports and communicating with LE's other facilities, the employee at the Ontario office will have other responsibilities. The employee will be responsible for making sure that the Sears Fraud Files are updated regularly (i.e., monthly). The employee will be responsible for maintaining records (electronic and print) on the credit checks run by the Ontario office. Finally, the employee will be responsible for making sure that the credit-check system (hardware and software) is functioning properly.

Finally, in a recent development, LE has decided to make its California presence more substantial by placing a LE product display and signage, distributing catalogs, and allowing for returns at the new Ontario location. LE also plans to include on its Internet website a statement that orders from California residents will be subject to a credit review in Ontario.

What is a FICO score?

A FICO score is a credit score developed by Fair Isaac & Co. Credit scoring is a method of determining the likelihood that credit users will pay their bills. Fair, Isaac began its pioneering work with credit scoring in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation. A credit score attempts to condense a borrower's credit history into a single number. Fair, Isaac & Co. and the credit bureaus do not reveal how these scores are computed. The Federal Trade Commission has ruled this to be acceptable.

Credit scores are calculated by using scoring models and mathematical tables that assign points for different pieces of information which best predict future credit performance. Developing these models involves studying how thousands, even millions, of people have used credit. Score-model developers find predictive factors in the data that have proven to indicate future credit performance. Models can be developed from different sources of data. Credit-bureau models are developed from information in consumer credit-bureau reports.

Credit scores analyze a borrower's credit history considering numerous factors such as:

- Late payments
- The amount of time credit has been established
- The amount of credit used versus the amount of credit available
- Length of time at present residence
- Employment history
- Negative credit information such as bankruptcies, charge-offs, collections, etc.

There are really three FICO scores computed by data provided by each of the three bureaus-Experian, Trans Union and Equifax. Some lenders use one of these three scores, while other lenders may use the middle score.

Revenue and Taxation Code
Chapter 3 The Use Tax
Article 1 Imposition of Tax

Section 6203 Collection by retailer, provides in part:

Every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state, not exempted under Chapter 3.5 (commencing with Section 6271) or Chapter 4 (commencing with Section 6351), shall, at the time of making the sales or, if the storage, use, or other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt therefor in the manner and form prescribed by the board.

(b) As respects leases constituting sales of tangible personal property, the tax shall be collected from the lessee at the time amounts are paid by the lessee under the lease.

(c) “Retailer engaged in business in this state” as used in this section and Section 6202 means and includes any of the following:

(1) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.

(2) Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.

Regulation 1699. PERMITS

References: Sections 6066-6075, Revenue and Taxation Code.

(a) IN GENERAL – NUMBER OF PERMITS REQUIRED. Every person engaged in the business of selling (or leasing under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers. For example:

A permit is required for a branch sales office at which orders are customarily taken and contracts negotiated, whether or not merchandise is stocked there.

No additional permits are required for warehouses or other places at which merchandise is merely stored and which customers do not customarily visit for the purpose of making purchases and which are maintained in conjunction with a place of business for which a permit is held; but at least one permit must be held by every person maintaining stocks of merchandise in this state for sale.

If two or more activities are conducted by the same person on the same premises, even though in different buildings, only one permit is required. For example:

A service station operator having a restaurant in addition to the station on the same premises requires only one permit for both activities.

(b) PERSONS SELLING IN INTERSTATE COMMERCE OR TO UNITED STATES GOVERNMENT. A permit is not required to be held by persons all of whose sales are made exclusively in interstate or foreign commerce but a permit is required of persons notwithstanding all their sales (or leases under a lease defined as a sale in Revenue and Taxation Code section 6006(g)) are made to the United States or instrumentalities thereof.

(c) PERSONS SELLING FEED. Effective April 1, 1996, a permit is not required to be held by persons whose sales consist entirely of sales of feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption (food animals), or for any form of animal life not of such a kind (nonfood animals) which are being held for sale in the regular course of business, provided no other retail sales of tangible personal property are made.

If a seller of hay is also the grower of the hay, this exemption shall apply only if either:

1. The hay is produced for sale only to beef cattle feedlots or dairies, or
2. The hay is sold exclusively through a farmer-owned cooperative.

(d) CONCESSIONAIRES. For the purposes of this regulation, the term concessionaire is defined as an independent retailer who is authorized, through contract with, or permission of, another retail business enterprise (the prime retailer), to operate within the perimeter of the prime retailer's own retail business premises, which to all intents and purposes appear to be wholly under the control of that prime retailer, and to make retail sales that to the general public might reasonably be believed to be the transactions of the prime retailer. Some indicators that a retailer is *not* operating as a concessionaire are that he or she:

- Appears to the public to be a business separate and autonomous from the prime retailer. Examples of businesses that may appear to be separate and autonomous, while operating within the prime retailer's premises, are those with signs posted on the premises naming each of such businesses, those with separate cash registers, and those with their own receipts or invoices printed with their business name.
- Maintains separate business records, particularly with respect to sales.
- Establishes his or her own selling prices.
- Makes business decisions independently, such as hiring employees or purchasing inventory and supplies.
- Registers as a separate business with other regulatory agencies, such as an agency issuing business licenses, the Employment Development Department, and/or the Secretary of State.
- Deposits funds into a separate account.

Regulation 1699 (continued)

In cases where a retailer is not operating as a concessionaire, the prime retailer is *not* liable for any tax liabilities of the retailer operating on his or her premises. However, if a retailer is deemed to be operating as a concessionaire, the prime retailer may be held jointly and severally liable for any sales and use taxes imposed on unreported retail sales made by the concessionaire while operating as a concessionaire. Such a prime retailer will be relieved of his or her obligation for sales and use tax liabilities incurred by such a concessionaire for the period in which the concessionaire holds a permit for the location of the prime retailer or in cases where the prime retailer obtains and retains a written statement that is taken in good faith in which the concessionaire affirms that he or she holds a seller's permit for that location with the Board. The following essential elements must be included in the statement in order to relieve the prime retailer of his or her liability for any unreported tax liabilities incurred by the concessionaire:

- The permit number of the concessionaire
- The location for which the permit is issued (must show the concessionaire's location within the perimeter of the prime retailer's location)
- Signature of the concessionaire
- Date

While any statement, taken timely, in good faith and containing all of these essential elements will relieve a prime retailer of his or her liability for the unreported sales or use taxes of a concessionaire, a suggested format of an acceptable statement is provided as Appendix A to this regulation. While not required, it is suggested that the statement from the concessionaire contain language to clarify which party will be responsible for reporting and remitting the sales and/or use tax due on his or her retail sales.

In instances where the lessor, or grantor of permission to occupy space, is not a retailer himself or herself, he or she is not liable for any sales or use taxes owed by his or her lessee or grantee. In instances where an independent retailer leases space from another retailer, or occupies space by virtue of the granting of permission by another retailer, but does not operate his or her business within the perimeter of the lessor's or grantor's own retail business, such an independent retailer is not a concessionaire within the meaning of this regulation. In this case, the lessor or grantor is not liable for any sales or use taxes owed by the lessee or grantee.

(e) AGENTS. If agents make sales on behalf of a principal and do not have a fixed place of business, but travel from house to house or from town to town, it is unnecessary that a permit be obtained for each agent if the principal obtains a permit for each place of business located in California. If, however, the principal does not obtain a permit for each place of business located in California, it is necessary for each agent to obtain a permit.

(f) INACTIVE PERMITS. A permit shall be held only by persons actively engaging in or conducting a business as a seller of tangible personal property. Any person not so engaged shall forthwith surrender his or her permit to the Board for cancellation. The Board may revoke the permit of a person found to be not actively engaged in or conducting a business as a seller of tangible personal property.

Upon discontinuing or transferring a business, a permit holder shall promptly notify the Board and deliver his or her permit to the Board for cancellation. To be acceptable, the notice of transfer or discontinuance of a business must be received in one of the following ways:

(1) Oral or written statement to a Board office or authorized representative, accompanied by delivery of the permit, or followed by delivery of the permit upon actual cessation of the business. The permit need not be delivered to the Board, if lost, destroyed or is unavailable for some other acceptable reason, but notice of cessation of business must be given.

(2) Receipt of the transferee or business successor's application for a seller's permit may serve to put the Board on notice of the transferor's cessation of business.

Notice to another state agency of a transfer or cessation of business does not in itself constitute notice to the Board.

Regulation 1699 (continued)

Unless the permit holder who transfers the business notifies the Board of the transfer, or delivers the permit to the Board for cancellation, he or she will be liable for taxes, interest and penalties (excluding penalties for fraud or intent to evade the tax) incurred by his or her transferee who with the permit holder's actual or constructive knowledge uses the permit in any way; e.g., by displaying the permit in transferee's place of business, issuing any resale certificates showing the number of the permit thereon, or filing returns in the name of the permit holder or his or her business name and under his or her permit number. Except in the case where, after the transfer, 80 percent or more of the real or ultimate ownership of the business transferred is held by the predecessor, the liability shall be limited to the quarter in which the business is transferred, and the three subsequent quarters.

Stockholders, bondholders, partners, or other persons holding an ownership interest in a corporation or other entity shall be regarded as having the "real or ultimate ownership" of the property of the corporation or other entity.

(g) DUE DATE OF RETURNS - CLOSEOUT OF ACCOUNT ON YEARLY REPORTING BASIS. Where a person authorized to file tax returns on a yearly basis transfers the business to another person or discontinues it before the end of the yearly period, a closing return shall be filed with the Board on or before the last day of the month following the close of the calendar quarter in which the business was transferred or discontinued.

(h) BUYING COMPANIES - GENERAL.

(1) DEFINITION. For the purpose of this regulation, a buying company is a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services, for the other entity. It is presumed that the buying company is formed for the operational reasons of the entity which owns or controls it or to which it is otherwise related. A buying company formed, however, for the sole purpose of purchasing tangible personal property ex-tax for resale to the entity which owns or controls it or to which it is otherwise related in order to re-direct local sales tax from the location(s) of the vendor(s) to the location of the buying company shall not be recognized as a separate legal entity from the related company on whose behalf it acts for purposes of issuing it a seller's permit. Such a buying company shall not be issued a seller's permit. Sales of tangible personal property to third parties will be regarded as having been made by the entity owning, controlling, or otherwise related to the buying company. A buying company that is not formed for the sole purpose of so re-directing local sales tax shall be recognized as a separate legal entity from the related company on whose behalf it acts for purposes of issuing it a seller's permit. Such a buying company shall be issued a seller's permit and shall be regarded as the seller of tangible personal property it sells or leases.

(2) ELEMENTS. A buying company is not formed for the sole purpose of re-directing local sales tax if it has one or more of the following elements:

(A) Adds a markup to its cost of goods sold in an amount sufficient to cover its operating and overhead expenses.

(B) Issues an invoice or otherwise accounts for the transaction.

The absence of any of these elements is not indicative of a sole purpose to redirect local sales tax.

(i) WEB SITES. The location of a computer server on which a web site resides may not be issued a seller's permit for sales tax purposes except when the retailer has a proprietary interest in the server and the activities at that location otherwise qualify for a seller's permit under this regulation.

Regulation 1699 (continued)

Appendix A

Certification of Permit – Concessionaires

I certify that I operate an independent business at the premises of the following retailer and that I hold a valid seller's permit to operate at this location, as noted below. I further understand that I will be solely responsible for reporting all sales that I make on those premises and remitting all applicable sales and use taxes due to the Board of Equalization:

Name of retailer on whose premises I operate my business: _____

Location of premises: _____

I hereby certify that the foregoing information is accurate and true to the best of my knowledge:

Certifier's Signature: _____ Date _____

Certifier's Printed Name _____

Certifier's Seller's Permit Number _____

Certifier's Business Name and Address* _____

Certifier's Telephone Number _____

*** Please Note:** The certifier *must* be registered to do business at the location of the retailer upon whose premises he or she is making retail sales.

Regulation 1620. Interstate and Foreign Commerce.

Reference: Sections 6006, 6008, 6009.1, 6051, 6201, 6247, 6352, 6366.2, 6368.5, 6387 and 6396, Revenue and Taxation Code.

(a) Sales Tax.

(1) IN GENERAL. When a sale occurs in this state, the sales tax, if otherwise applicable, is not rendered inapplicable solely because the sale follows a movement of the property into this state from a point beyond its borders, or precedes a movement of the property from within this state to a point outside its borders. Such movements prevent application of the tax only when conditions exist under which the taxing of the sale, or the gross receipts derived therefrom, is prohibited by the United States Constitution or there exists a statutory exemption. If title to the property sold passes to the purchaser at a point outside this state, or if for any other reason the sale occurs outside this state, the sales tax does not apply, regardless of the extent of the retailer's participation in California in relation to the transaction. The retailer has the burden of proving facts establishing his right to exemption.

(2) Sales Following Movement of Property Into State From Point Outside State.

(A) From Other States - When Sales Tax Applies. Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any local branch, office, outlet or other place of business of the retailer in this state, or agent or representative operating out of or having any connection with, such local branch, office, outlet or other place of business and the sale occurs in this state. The term "other place of business" as used herein includes the homes of district managers, service representatives, and other resident employees, who perform substantial services in relation to the retailer's functions in this state. It is immaterial that the contract of sale requires or contemplates that the goods will be shipped to the purchaser from a point outside the state. Participation in the transaction in any way by the local office, branch, outlet or other place of business is sufficient to sustain the tax.

(B) From Other States - When Sales Tax Does Not Apply. Sales tax does not apply when the order is sent by the purchaser directly to the retailer at a point outside this state, or to an agent of the retailer in this state, and the property is shipped to the purchaser, pursuant to the contract of sale, from a point outside this state directly to the purchaser in this state, or to the retailer's agent in this state for delivery to the purchaser in this state, provided there is no participation whatever in the transaction by any local branch, office, outlet or other place of business of the retailer or by any agent of the retailer having any connection with such branch, office, outlet, or place of business.

(C) Imports. Sales tax applies to sales of property imported into this state from another country when the sale occurs after the process of importation has ceased, regardless of whether the property is in its original package, if the transaction is otherwise subject to sales tax under subdivision (a)(2)(A) of this regulation.

(3) SALES PRECEDING MOVEMENT OF GOODS FROM WITHIN STATE TO POINTS OUTSIDE STATE.

(A) To Other States - When Sales Tax Applies. Except as otherwise provided in (B) below, sales tax applies when the property is delivered to the purchaser or the purchaser's representative in this state, whether or not the disclosed or undisclosed intention of the purchaser is to transport the property to a point outside this state, and whether or not the property is actually so transported. It is immaterial that the contract of sale may have called for the shipment by the retailer of the property to a point outside this state, or that the property was made to specifications for out-of-state jobs, that prices were quoted including transportation charges to out-of-state points, or that the goods are delivered to the purchaser in this state via a route a portion of which is outside this state. Regardless of the documentary evidence held by the retailer (see (3)(D) below) to show delivery of the property was made to a carrier for shipment to a point outside the state, tax will apply if the property is diverted in transit to the purchaser or his representative in this state, or for any other reason it is not delivered outside this state.

(B) Shipments Outside the State - When Sales Tax Does Not Apply. Sales tax does not apply when the property pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer, by means of:

Regulation 1620 (continued)

1. Facilities operated by the retailer or

2. Delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point. As used herein the term "carrier" means a person or firm regularly engaged in the business of transporting for compensation tangible personal property owned by other persons, and includes both common and contract carriers. The term "forwarding agent" means a person or firm regularly engaged in the business of preparing property for shipment or arranging for its shipment. An individual or firm not otherwise so engaged does not become a "carrier" or "forwarding agent" within the meaning of this regulation simply by being designated by a purchaser to receive and ship goods to a point outside this state. (This subsection is effective on and after September 19, 1970, with respect to deliveries in California to carriers, etc., hired by the purchasers for shipment to points outside this state that are not in another state or foreign country, e.g., to points in the Pacific Ocean.)

(C) Exports.

1. When Sales Tax applies. Except for certain new motor vehicles delivered to a foreign country pursuant to paragraph (b)(2)(D) of Regulation 1610 (18 CCR 1610), sales tax applies when the property is delivered in this state to the purchaser or the purchaser's representative prior to an irrevocable commitment of the property into the process of exportation. It is immaterial that the disclosed or undisclosed intention of the purchaser is to ship or deliver the property to a foreign country or that the property is actually transported to a foreign country.

Sales of property such as fuel oil and other items consumed during a voyage to a foreign country are not exempt even though they are transported out of, and are not returned to this country. It is immaterial that the ship to which the property is delivered is of foreign registry.

2. When Sales Tax Does Not Apply. Sales tax does not apply when the property is sold to a purchaser for shipment abroad and is shipped or delivered by the retailer to a foreign country. To be exempt as an export the property must be intended for a destination in a foreign country, it must be irrevocably committed to the exportation process at the time of sale, and must actually be delivered to the foreign country prior to any use of the property. Movement of the property into the process of exportation does not begin until the property has been shipped, or entered with a common carrier for transportation to another country, or has been started upon a continuous route or journey which constitutes the final and certain movement of the property to its foreign destination.

There has been an irrevocable commitment of the property to the exportation process when the property is sold to a purchaser for shipment abroad and is shipped or delivered by the retailer in a continuous route or journey to the foreign country by means of:

a. Facilities operated by the retailer,

b. A carrier, forwarding agent, export packer, customs broker or other person engaged in the business of preparing property for export, or arranging for its export, or

c. A ship, airplane, or other conveyance furnished by the purchaser for the purpose of carrying the property in a continuous journey to the foreign country, title to and control of the property passing to the purchaser upon delivery. Delivery by the retailer of property into a facility furnished by the purchaser constitutes an irrevocable commitment of the property into the exportation process only in those instances where the means of transportation and character of the property shipped provide certainty that the property is headed for its foreign destination and will not be diverted for domestic use. The following are examples of deliveries by the retailer into facilities furnished by the purchaser which demonstrate an irrevocable commitment of the property into the exportation process:

Example 1. Sale of fuel oil delivered into the hold of a vessel provided by the purchaser. The fuel is to be unloaded at the foreign destination.

Example 2. Sale of jewelry delivered aboard a scheduled airline with a scheduled departure to a foreign destination.

Example 3. Sale of equipment, designed specifically for use in the foreign destination, delivered to a foreign purchaser's aircraft. The foreign purchaser has filed a flight plan showing that the aircraft will be transporting the property on a continuous journey to its foreign destination.

Regulation 1620 (continued)

The following are examples of sales which do not demonstrate sufficient indicia of an irrevocable commitment to the exportation process and do not qualify as exports:

Example 4. Sale of jewelry delivered to a foreign purchaser at the retailer's place of business or to the purchaser or his representative at the airport prior to boarding the plane. The tax applies even though the purchaser may hold tickets for the foreign destination.

Example 5. Sale of a television set delivered into the trunk of a passenger vehicle or into the storage area of a pickup truck.

Example 6. Sale of equipment delivered to a foreign purchaser's aircraft even though a flight plan had been filed showing that the aircraft was to be flown to a foreign destination. If the equipment sold had been altered or specifically designed for use in the foreign destination, then the combined factors of the character of the property and the means of transportation would provide certainty of export and the sale would qualify as an export as described in (3) above.

Export has not begun where property is transported from a point within this state to a warehouse or other collecting point in this state even though it is intended that the property then be transported, and in fact is transported, to another country. Nevertheless, sales of property are exempt if transported under the circumstances described in 2.(b) above to a warehouse or other collecting point of a carrier, forwarding agent, export packer, customs broker, or other person engaged in the business of preparing property for export, or arranging for its export. Property is regarded as transported under the circumstances described in 2.(b) above, when the property is sold to a purchaser for shipment abroad and is shipped or delivered to a point in this state to a person who is not the purchaser, whether or not that person is a legal entity related to the purchaser, who ships or delivers the property to a foreign destination as provided in paragraph (a)(3)(C)2.(b) of this regulation.

(D) Proof of Exemption. Bills of lading or other documentary evidence of the delivery of the property to a carrier, customs broker, or forwarding agent for shipment outside this state must be retained by the retailer to support deductions taken under (B) above. Bills of lading, import documents of a foreign country or other documentary evidence of export must be obtained and retained by retailers to support deductions taken under (C) above.

(E) Particular Applications.

1. Property Mailed to Persons in the Armed Forces. Tax does not apply to sales of property which is mailed by the retailer, pursuant to the contract of sale, to persons in the armed forces at points outside the United States, notwithstanding the property is addressed in care of the postmaster at a point in this state and forwarded by him to the addressee.

When mail is addressed to Army Post Offices (A.P.O.'s) or to Fleet Post Offices (F.P.O.'s) in care of the postmaster, it will be presumed that it is forwarded outside California. The retailer must keep records showing the names and addresses as they appear on the mailed matter and should keep evidence that the mailing was done by him.

2. Property for Defense Purposes Delivered to Offices of the United States. Tax does not apply to sales of property shipped to a point outside this state pursuant to the contract of sale when the property is marked for export and delivered by retailer to the "contracting officer," "officer in charge," port quartermaster," or other officer of the United States for transportation and delivery to the purchaser at such a point.

3. Airplanes Delivered to Agencies of the United States. Tax does not apply to sales of airplanes and parts and equipment for airplanes transported to a point outside this state pursuant to the contract of sale when such property is delivered to the United States Air Force or any other agency or instrumentality of the United States for transportation and delivery to the purchaser or someone designated by him at that point.

4. Repairers. When repairers of property in California, in fulfillment of their repair contracts with their customers, ship the repaired property to points outside this state by one of the methods set forth under (a)(3)(B) and (C) above, tax does not apply to the sale by the repairer of the repair parts and materials affixed to and becoming a component part of the repaired property so shipped.

(b) USE TAX.

(1) IN GENERAL. Use tax applies to the use of any property purchased for storage, use or other consumption and stored, used, or consumed in this state, the sale of which is exempt from sales tax under this regulation.

Regulation 1620 (continued)

(2) EXCEPTIONS.

(A) Use tax does not apply to the use of property held or stored in this state for sale in the regular course of business nor to the use of property held for the purposes designated in subparagraph (b)(6), below.

(B) Interstate and Foreign Commerce.

1. IN GENERAL. Use tax does not apply to the use of property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.

2. INTERMODAL CARGO CONTAINERS. Intermodal cargo containers are containers that are used to transport freight during a continuous movement of that freight from the origin shipper to the destination receiver by the use of two or more of the following modes of transportation: railroad, vehicle, or vessel. The use of an intermodal cargo container in California is exempt from tax if the use meets the requirements of subdivision (b)(2)(B)1 of this regulation. An intermodal cargo container is regarded as first used in interstate or foreign commerce prior to its entry into California if the container is loaded with freight outside California and then first enters California during a continuous movement of that freight from the origin shipper to the destination receiver. For purposes of the requirements set forth in subdivision (b)(2)(B)1 of this regulation, an intermodal cargo container is also regarded as first used in interstate or foreign commerce prior to its entry into California if all of the following conditions are satisfied:

a. The contract for the sale or lease of the intermodal cargo container requires that the container be used in interstate or foreign commerce and such sales contract or lease contract is entered into prior to the entry of the intermodal cargo container into California;

b. The purchaser or lessee transports the intermodal cargo container into California with the specific intent that such intermodal cargo container will then be loaded with freight for transport in a continuous movement to a destination outside California, whether or not the purchaser knows which particular freight will be loaded into the intermodal cargo container at the time the intermodal cargo container first enters California; and

c. The intermodal cargo container is, in fact, first loaded with freight for transport in a continuous movement to a destination outside California, and the intermodal cargo container is thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.

(C) Use tax does not apply to the use of certain new motor vehicles purchased for subsequent delivery to a foreign country and so delivered pursuant to paragraph (b)(2)(D) of Regulation 1610 (18 CCR 1610).

(3) PURCHASE FOR USE IN THIS STATE. Property delivered outside of California to a purchaser known by the retailer to be a resident of California is regarded as having been purchased for use in this state unless a statement in writing, signed by the purchaser or the purchaser's authorized representative, that the property was purchased for use at a designated point or points outside this state is retained by the vendor.

Notwithstanding the filing of such a statement, property purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California. For purposes of this regulation, "functional use" means use for the purposes for which the property was designed. When the property is first functionally used outside of California, the property will nevertheless be presumed to have been purchased for use in this state if it is brought into California within 90 days after its purchase, unless the property is used, stored, or both used and stored outside of California one-half or more of the time during the six-month period immediately following its entry into this state. Prior out-of-state use not exceeding 90 days from the date of purchase to the date of entry into California is of a temporary nature and is not proof of an intent that the property was purchased for use elsewhere. Prior out-of-state use in excess of 90 days from the date of purchase to the date of entry into California, exclusive of any time of shipment to California, or time of storage for shipment to California, will be accepted as proof of an intent that the property was not purchased for use in California.

(4) PURCHASE FOR USE IN THIS STATE – VEHICLES, VESSELS AND AIRCRAFT. A vehicle, vessel or aircraft purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the vehicle, vessel or aircraft is in California. When the vehicle, vessel or aircraft is first functionally used outside of California, the vehicle, vessel or aircraft will nevertheless be presumed to

Regulation 1620 (continued)

have been purchased for use in this state if it is brought into California within 90 days after its purchase, exclusive of any time of shipment to California or time of storage for shipment to California, unless:

(A) Physically Located Outside California. Use tax will not apply if the vehicle, vessel or aircraft is used, stored, or both used and stored outside of California one-half or more of the time during the six-month period immediately following its entry into this state.

(B) Used in Interstate or Foreign Commerce.

1. . If the property is a vehicle, use tax will not apply if one-half or more of the miles traveled by the vehicle during the six-month period immediately following its entry into this state are commercial miles traveled in interstate or foreign commerce.

2. If the property is a vessel, use tax will not apply if one-half or more of the nautical miles traveled by the vessel during the six-month period immediately following its entry into the state are commercial miles traveled in interstate or foreign commerce.

3. If the property is an aircraft, use tax will not apply if one-half or more of the flight time traveled by the aircraft during the six-month period immediately following its entry into the state is commercial flight time traveled in interstate or foreign commerce.

Such use will be accepted as proof of an intent that the property was not purchased for use in California. For purposes of subdivision (b)(4), the term "commercial" applies to business uses and excludes personal use. However, the term "commercial" is not limited to for-profit businesses.

Examples of what constitutes interstate or foreign commerce include, but are not limited to the following:

Example 1. A sightseeing tour bus group (charter) or regularly scheduled bus service (per capita) originates in California and travels to another state or country for a single day or several days, then returns to California where the charter or schedule terminates.

Example 2. A charter bus, vessel or aircraft deadheads under contract to another state, picks up the group and operates the charter without entering the state of California, drops the group in the other state, and deadheads back into the State of California. (The charter was quoted round trip.)

Example 3. A commercial vehicle deadheads to another state or country or transports property to another state or country and delivers that property within the other state or country or to another state or country. The vehicle then returns to California, either loaded or empty.

Example 4. A charter bus group tours under contract to another state or country for a day or several days, drops the passengers in the other state or country, and then deadheads back under contract to its terminal or next assignment.

Example 5. Property arriving in California via plane, train, or vessel from another state or country is picked up by a commercial vehicle, vessel or aircraft and transported to another state or country for a day or several days. The commercial vehicle, vessel or aircraft then returns to California, either loaded or empty.

Example 6. A sightseeing tour bus group (charter) arriving in California via plane, train, or ship from another state or country is picked up by bus and tours California for a number of days, goes to another state or country for a number of days, and then terminates service either in another state, country, or California.

Example 7. Property arriving in California via plane, train, or vessel from another state or country is picked up by a commercial vehicle, vessel or aircraft, which may be operating wholly within California, and transported for further distribution to one or more California locations or to locations in another state or country. The vehicle, vessel or aircraft then returns empty to pick up another load arriving in California via plane, train, or vessel from another state or country.

Example 8. A commercial vehicle, vessel, aircraft, or regularly scheduled bus service operating wholly within California is picking up or feeding passengers or property arriving from, or destined to, a state or country other than California to another form of transportation be it plane, train, ship, or bus. (Example: an airport bus service or a bridge carrier for Amtrak.)

Regulation 1620 (continued)

Example 9. Property is transported by a commercial vehicle, vessel or aircraft from another state or country to California or from California to another state or country. While engaged in this transportation, the commercial vehicle, vessel or aircraft also transports property from one point in California to another.

Example 10. A commercial vehicle, vessel or aircraft is dispatched from one location in California to another location in California to pick up property and transport it to another state or country.

Example 11. A commercial vehicle, vessel or aircraft, sightseeing tour bus group (charter), or regularly scheduled bus service operating in interstate or foreign commerce experiences a mechanical failure and is replaced by another vehicle, vessel or aircraft. The replacement vehicle, vessel or aircraft is also deemed to be operating in interstate or foreign commerce as a continuation of the original trip.

Example 12. A vehicle, vessel or aircraft transports persons or property for commercial purposes (a) from California to another state or country; (b) from another state or country to California; (c) entirely within California, but the vehicle, vessel or aircraft picks up persons or property arriving in California via train, bus, truck, vessel, or aircraft from another state or country and then transports the persons or property in a continuous route or journey to one or more California locations or to locations in another state or country.

Example 13. A vessel transports persons or property for commercial purposes (a) from a California port to a port in another state or country; or (b) from a port in another state or country to a port in California.

(5) **IMPORTS.** Use tax applies with respect to purchases of property imported into this state from another country when the use occurs after the process of importation has ceased and when sales tax is not applicable, regardless of whether the property is in its original package.

(6) **"STORAGE" AND "USE" - EXCLUSIONS.** "Storage" and "use" do not include the keeping, retaining or exercising any right or power over property for the purposes of subsequently transporting it outside the state for use thereafter solely outside the state, or for the purpose of being processed, fabricated or manufactured, into, attached to, or incorporated into, other property to be transported outside the state and thereafter used solely outside the state.

The following examples are illustrative of the meaning of the exclusion:

Example 1. An engine installed in an aircraft which is flown directly out of the state for use thereafter solely outside the state qualifies for the exclusion. The use of the engine in the transporting process does not constitute a use for purposes of the exclusion. However, if any other use is made of the aircraft during removal from this state, such as carrying passengers or property, the exclusion does not apply.

Example 2. An engine installed in a truck which is transported by rail or air directly out of the state for use thereafter solely outside the state qualifies for the exclusion.

Example 3. An engine transported outside the state and installed on an aircraft which returns to the state does not qualify for the exclusion. It does not matter whether the use of the aircraft in California is exclusively interstate or intrastate commerce or both.

Example 4. An engine transported outside the state and installed on an aircraft which does not return to the state, qualifies for the exclusion.

(c) RAIL FREIGHT CARS. Sales tax does not apply to the sale of, and the use tax does not apply to the storage, use or other consumption in this state of rail freight cars for use in interstate or foreign commerce.

Regulation 1802. PLACE OF SALE AND USE FOR PURPOSES OF BRADLEY BURNS UNIFORM LOCAL SALES AND USE TAXES.

References: Sections 6012.6, 6015, 6359, 6359.45, 7202, 7204.03 and 7205, Revenue and Taxation Code.

(a) IN GENERAL.

(1) **RETAILERS HAVING ONE PLACE OF BUSINESS.** For the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law, if a retailer has only one place of business in this state, all California retail sales of that retailer in which that place of business participates occur at that place of business unless the tangible personal property sold is delivered by the retailer or his or her agent to an out-of-state destination, or to a common carrier for delivery to an out-of-state destination.

(2) **RETAILERS HAVING MORE THAN ONE PLACE OF BUSINESS.**

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

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

(3) **PLACE OF PASSAGE OF TITLE IMMATERIAL.** If title to the tangible personal property sold passes to the purchaser in California, it is immaterial that title passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that the property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.

(b) PLACE OF SALE IN SPECIFIC INSTANCES.

(1) **VENDING MACHINE OPERATORS.** The place of sale is the place at which the vending machine is located. If an operator purchases property under a resale certificate or from an out-of-state seller without payment of tax and the operator is the consumer of the property, for purposes of the use tax, the use occurs at the place where the vending machine is located.

(2) **ITINERANT MERCHANTS.** The place of sale with respect to sales made by sellers who have no permanent place of business and who sell from door to door for their own account shall be deemed to be in the county in which is located the seller's permanent address as shown on the seller's permit issued to him or her. If this address is in a county imposing sales and use taxes, sales tax applies with respect to all sales unless otherwise exempt. If this address is not in a county imposing sales and use taxes, he or she must collect the use tax with respect to property sold and delivered or shipped to customers located in a county imposing sales and use taxes.

(3) **RETAILERS UNDER SECTION 6015.** Persons regarded by the Board as retailers under Section 6015(b) of the Revenue and Taxation Code are regarded as selling tangible personal property through salespersons, representatives, peddlers, canvassers or agents who operate under or obtain the property from them. The place of sale shall be deemed to be:

(A) the business location of the retailer if the retailer has only one place of business in this state, exclusive of any door-to-door solicitations of orders, or

(B) the business location of the retailer where the principal negotiations are carried on, exclusive of any door-to-door solicitations of orders, if more than one in-state place of business of the retailer participates in the sale.

The amendments to paragraph (b)(3) apply only to transactions entered into on or after July 1, 1990.

(4) **AUCTIONEERS.** The place of sale by an auctioneer is the place at which the auction is held. Operative July 1, 1996, auctioneers shall report local sales tax revenue to the participating jurisdiction (as defined in subdivision (c) below) in which the sales take place, with respect to auction events which result in taxable sales in an aggregate amount of \$500,000 or more.

Regulation 1802 (continued)

(5) OUT-OF-STATE RETAILERS WHO MAINTAIN A STOCK OF TANGIBLE PERSONAL PROPERTY IN CALIFORNIA. Operative October 1, 1993, if an out-of-state retailer does not have a permanent place of business in this state other than a stock of tangible personal property, the place of sale is the city, county, or city and county from which delivery or shipment is made. Local tax collected by the Board for such sales will be distributed to that city, county, or city and county.

(6) FACTORY-BUILT SCHOOL BUILDINGS. The place of sale or purchase of a factory-built school building (relocatable classroom) as defined in paragraph (c)(4)(B) of Regulation 1521 (18 CCR 1521), Construction Contractors, is the place of business of the retailer of the factory-built school building regardless of whether sale of the building includes installation or whether the building is placed upon a permanent foundation.

(7) JET FUEL.

(A) In General. The place of sale or purchase of jet fuel is the city, county, or city and county which is the point of the delivery of the jet fuel to the aircraft, if both of the following conditions are met:

1. The principal negotiations for the sale are conducted at the retailer's place of business in this state; and
2. The retailer has more than one place of business in the state.

(B) The local sales or use tax revenue derived from the sale or purchase of jet fuel under the conditions set forth in this subdivision shall be transmitted by the Board, to the city, county, or city and county where the airport is located at which such delivery occurs.

(C) Multi-Jurisdictional Airports. For the purposes of this regulation, the term "multi-jurisdictional airport" means and includes an airport that is owned or operated by a city, county, or city and county, that has enacted a state-administered local sales and use tax ordinance and as to which the owning or operating city, county, or city and county is different from the city, county, or city and county in which the airport is located. The 1.25% local tax revenue derived from sales of jet fuel at a "multi-jurisdictional airport" shall, notwithstanding Subdivision (B), be transmitted by the Board as follows:

1. In the case of the 0.25% local sales tax imposed by counties under Government Code section 29530 and Revenue and Taxation Code section 7202(a), half of the revenue to the county which owns or operates the airport (or in which the city which owns or operates the airport is located) and half to the county in which the airport is located.

2. In the case of the remaining 1% of the local sales tax imposed by counties under Revenue and Taxation Code section 7202(a), and in the case of the local sales tax imposed by cities at a rate of up to 1% and offset against the local sales tax of the county in which the city is located under Revenue and Taxation Code section 7202(h), half of the revenue to the city which owns or operates the airport and half to the city in which the airport is located. If the airport is either owned or operated by a county or is located in the unincorporated area of a county, or is owned or operated by a county and is located in the unincorporated area of a different county, the local sales tax revenue which would have been transmitted to a city under this subdivision shall be transmitted to the corresponding county.

3. Notwithstanding the rules specified in Subdivisions 1. and 2., the following special rules apply:

- a. In the case of retail sales of jet fuel in which the point of the delivery of the jet fuel to the aircraft, as described in subdivision (A), is San Francisco International Airport, the Board shall transmit one-half of the local sales tax revenues derived from such sales to the City and County of San Francisco, and the other half to the County of San Mateo.

- b. In the case of retail sales of jet fuel in which the point of the delivery of the jet fuel to the aircraft, as described in Subdivision (A), is Ontario International Airport, the Board shall transmit local sales taxes with respect to those sales in accordance with both of the following:

- c. All of the revenues that are derived from a local sales tax imposed by the City of Ontario shall be transmitted to that city.

- d. All of the revenues that are derived from a local sales tax imposed by the County of San Bernardino shall be allocated to that county.

Regulation 1802 (continued)

(D) Otherwise, as provided elsewhere in this regulation.

(c) ALLOCATION OF SALES TAX AND APPLICATION OF USE TAX.

Local sales tax is allocated to the place where the sale is deemed to take place under the above rules. The local use tax ordinance of the jurisdiction where the property at issue is put to its first functional use applies to such use. As used in this subdivision, the term "participating jurisdiction" means any city, city and county, or county which has entered into a contract with the Board for administration of that entity's local sales and use tax.

APPLICATION OF USE TAX GENERALLY.

(1) When the order for the property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state from a point outside this state, the transaction is subject to the local use tax ordinance of the participating jurisdiction where the first functional use is made. Operative July 1, 1996, for transactions of \$500,000 or more, except with respect to persons who register with the Board to collect use tax under Regulation 1684(b) (18 CCR 1684), the seller shall report the local use tax revenues derived therefrom directly to such participating jurisdiction.

(2) Operative July 1, 1996, if a person who is required to report and pay use tax directly to the Board makes a purchase in the amount of \$500,000 or more, that person shall report the local use tax revenues derived therefrom to the participating jurisdiction in which the first functional use of the property is made.

The amendments to paragraph (b)(4) and new paragraph (c) shall apply prospectively only to transactions entered into on or after July 1, 1996. New paragraph (c) shall not apply to lease transactions.

Regulation 1628. TRANSPORTATION CHARGES.

Reference: Sections 6010.5, 6011, 6012, Revenue and Taxation Code.

(a) TRANSPORTATION BY CARRIER. Except as provided in paragraph (c) below, in the case of a sale, whether by lease or otherwise, tax does not apply to “separately stated” charges for transportation of property from the retailer’s place of business or other point from which shipment is made “directly to the purchaser,” provided the transportation is by other than facilities of the retailer, i.e., by United States mail, independent contract or common carrier. The place where the sale occurs, i.e., title passes to the customer or the lease begins, is immaterial, except when the property is sold for a delivered price or the transportation is by facilities of the retailer, as explained in (b) below. The amount of transportation charges excluded from the measure of tax shall not exceed the cost of the transportation to the retailer.

Transportation charges will be regarded as “separately stated” only if they are separately set forth in the contract for sale or in a document reflecting that contract, issued contemporaneously with the sale, such as the retailer’s invoice. The fact that the transportation charges can be computed from the information contained on the face of the invoice or other document will not suffice as a separate statement. If a separately stated charge is made designated “postage and handling” or “shipping and handling”, only that portion of the charge which represents actual postage or actual shipment may be excluded from the measure of tax. Such amounts may be excluded from the measure of tax even though such amounts are not affixed to, or noted on, the package. A separately stated charge designated “handling” or “handling charge” is not a separate statement of transportation charges. Tax applies to such charges, notwithstanding the fact that postage or shipment charges may or may not be affixed to or noted on the package.

Property will not be considered delivered “directly to the purchaser” if it is shipped to the retailer, to the retailer’s agent or representative, or to anyone else acting in the retailer’s behalf. Any separately stated charges by the retailer for the transportation of property to, rather than from, the retailer’s place of business, or to another point from which the property will then be “delivered directly to the purchaser,” are included in the measure of tax. Such charges represent incoming freight and are taxable as part of the cost of the property sold by the retailer.

(b) TRANSPORTATION BY RETAILER’S FACILITIES OR PROPERTY SOLD FOR DELIVERED PRICE.

(1) DEFINITION. “Delivered Price.” Property is sold for a delivered price when the price agreed upon in the contract for sale includes whatever cost or charge may be made for transportation of the property directly to the purchaser. A sale for a “guaranteed price” including a separately stated amount for transportation is a sale for a “delivered price.” Property is not sold for a delivered price when the price is agreed upon and to this price is added a separately stated amount representing the cost or charge for transportation of the property directly to the purchaser and any increase or decrease in the actual cost of transportation is borne by or credited to the purchaser.

(2) IN GENERAL. Except as provided in paragraph (c) below, when transportation is by facilities of the retailer or the property is sold for a delivered price, tax applies to charges for transportation to the purchaser, unless (A) the transportation charges are separately stated, (B) are for transportation from the retailer’s place of business or other point from which shipment is made directly to the purchaser, and (C) the transportation occurs after the sale of the property is made to the purchaser. When the sale occurs before the transportation to the purchaser commences, the tax does not apply to separately stated charges for the transportation. The amount that may be excluded from the measure of the tax cannot exceed a reasonable charge for transportation by facilities of the retailer or the cost of transportation by other than facilities of the retailer.

(3) DETERMINATION OF WHEN SALE OCCURS.

(A) Security Agreements. When a sale is made pursuant to a security agreement in which the retailer retains the title as security for the payment of the price, the sale occurs when possession of the property is transferred by the retailer to the purchaser or other person at the purchaser’s direction.

(B) Leases. When the sale is by lease, the sale occurs upon the transfer of possession or granting of the right of possession of the property by the lessor to the lessee or other person at his direction.

(C) Sale on Approval. When the sale is on approval, the sale does not occur until the purchaser accepts the property.

(D) Other Sales. Unless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and place at which the retailer completes his performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different time or place. If the contract requires or authorizes the retailer to send the property to the purchaser but does not require him to deliver it at destination, the retailer completes his performance with reference to the physical delivery of the property at the time and place of shipment, e.g., delivery of the property to a carrier for delivery by the carrier to the purchaser; but if the contract expressly requires delivery at destination, including cases where one of the terms of the contract is F.O.B. place of destination, the retailer completes his performance with reference to the physical delivery of the property on tender to the purchaser there. When delivery of the property is by facilities of the retailer, title passes when the property is delivered to the purchaser at the destination unless there is an explicit written agreement executed prior to the delivery that title is to pass at some other time.

(4) PLACE OF SALE. For the purposes of the State Sales and Use Tax Law (but not for the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law nor for the purposes of the Transactions and Use Tax Law) the place of the sale or purchase of tangible personal property is the place where the property is physically located at the time the act constituting the sale or purchase takes place.

(c) TRANSPORTATION OF LANDFILL MATERIAL. Operative January 1, 1989, tax does not apply to separately stated charges for transportation of landfill material, e.g., sand, dirt or gravel, removed from the ground and transported from the excavation site to a landfill site specified by the purchaser if:

(1) the amount of transportation charges excluded from the measure of tax does not exceed a reasonable charge for transportation by facilities of the retailer or the cost of the transportation by other than facilities of the retailer, or

(2) the consideration received is solely for the purpose of transporting the material to a specified site and the material is transferred without charge. If such transportation charges are in excess of a reasonable charge for transportation by facilities of the retailer or in excess of the cost of the transportation by other than facilities of the retailer, the provisions of this paragraph will not apply.

For purposes of this paragraph, it is immaterial when title passes to the purchaser of the landfill material.

APPENDIX

(a) EXAMPLES OF CONTRACT FOR DELIVERED PRICE.

(1) The contract for sale provides for the sale of property for \$100 per unit delivered to the purchaser.

(2) The contract for sale provides for the sale of property for \$100 per unit "which includes cost of delivery at \$10 per unit."

(3) The contract for sale provides for the sale of property for \$100 per unit delivered, freight prepaid.

(4) The contract for sale provides for the sale of property for \$100 per unit freight collect and allowed.

(5) The contract for sale calls for the sale of property for a guaranteed price of \$100 consisting of \$90 plus \$10 freight.

(b) EXAMPLES OF CONTRACTS WHICH ARE NOT FOR A DELIVERED PRICE.

(1) The contract for sale provides for the sale of property for \$100 per unit freight collect.

(2) The contract for sale provides for the sale of property for \$100 per unit actual freight prepaid and added to the sales price.

(c) EXAMPLES OF APPLICATION OF TAX. All deliveries are by independent carrier. All billings are in accordance with the terms of the contract.

(1) The contract for sale provides for the sale of property for \$100 per unit delivered to the purchaser with freight prepaid.

Tax applies to sales price of \$100 per unit with no deduction for freight charge since the freight charges are not separately stated. The contract is for a delivered price and requires delivery to the purchaser. Title does not pass to the purchaser prior to delivery.

(2) Contract for sale provides for the sale of property for \$100 per unit. The retailer is required to ship the property to the purchaser freight collect.

Tax applies to \$100 per unit since the responsibility for the payment of the freight is upon the purchaser, and the seller makes no charge for freight. Since the carrier will bill the purchaser for the actual freight charge, there will be a separate statement of the freight. The property is not sold for a delivered price.

(3) The contract for sale provides for the sale of property for \$100 per unit freight collect and allowed. The measure of tax is \$100 per unit less the amount of the freight paid to the carrier and shown on the payment voucher sent to the retailer by the purchaser.

The sale is for a delivered price. Separately stated transportation charges are excludable from the measure of tax since the transportation occurred after the sale of the property. If the contract for sale explicitly provided for passage of title upon delivery to the destination, then the measure of tax would be \$100 per unit since the sale was for a delivered price and title did not pass prior to transportation.

(4) The contract for sale provides for the sale of property for \$100 per unit plus actual freight of \$10 per unit. Any increase or decrease in the freight is for the account of the buyer.

Tax applies to \$100 per unit since the contract is not for a delivered price and shipment is by independent carrier.

(5) The contract for sale provides for the sale of property for \$100 plus freight of \$10, and the seller guarantees the price will not exceed \$110.

Tax applies to \$100 because the sale is for a delivered price and there is no showing that title was to pass upon delivery at the destination. A contract will be construed as a shipment contract unless it expressly requires delivery at destination point. If the contract for sale explicitly provided for passage of title upon delivery to the destination, then the measure of tax would be \$110 since the sale was for a delivered price and title did not pass prior to transportation.

(6) The contract for sale provides for the sale of property for \$100 per unit freight equalized with x city. The invoice shows 10 units at \$100 per unit, \$1,000, freight from x city \$100, total \$1,100.

Under these circumstances, tax applies to \$1,000 since the only separate statement of freight is the freight equalized with x city in the amount of \$100. If the actual freight paid to the carrier for the transportation of the property from the retailer's place of business or other point from which shipment is made directly to the purchaser is less than \$100, the exclusion will be limited to the amount paid to the carrier.

(7) Assuming the same facts as above, except the invoice shows 10 units at \$100 per unit, \$1,000, freight equalized with x city \$100, total \$1,100. The invoice also shows the notation, "Actual freight prepaid from point of shipment to destination is \$200."

The sale is not for a delivered price. On the basis of the above billing, a separate statement of freight is made in the amount of \$200. Accordingly, the measure of tax is \$1,100 minus \$200, or \$900.

April 12, 2004

Honorable Carole Migden, Chairwoman
State Board of Equalization
450 "N" Street, MIC: 71
Sacramento, CA 94814

**RE: Issuance of Seller's Permit to Locations Where Only Credit Checks or
Similar Activities are Performed**

Dear Chairwoman Migden:

The City of San Jose opposes the Board considering Lands' End's position that the Board allocate to the City of Ontario the local tax it currently allocates to the county pools. It is our opinion that Lands' End's argument to justify a second credit check location as a retail location in Ontario is not valid.

Section 7205 of the Uniform Local Sales and Use Tax Law, interpreted and implemented by Regulation 1802, provides that for the purposes of local tax allocation, all retail sales are consummated at the retailer's place of business unless the property is delivered to a point outside this state. Please note section 7205 indicates the word "consummated". Webster's dictionary defines the word consummated as "Finish or complete, as a business deal". The location in Ontario fails to start or finish the sale of any tangible personal property with the customer since it does not negotiate the sale or process the order for the customer.

The sales tax is a tax on the retailer's exercise of its privilege of selling. (City of Pomona v. St. Bd. of Equal. (1959) 53 Cal.2d 305.) To be a place of business of the retailer under Regulation 1802, the location must be a place in which the retailer has a proprietary interest and at which the retailer negotiates sales to customers and to which a seller's permit may be issued under Regulation 1699.

Regulation 1699 States that "...Every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a permit for each place of business in this state at which transactions

relating to sales are customarily negotiated with his or her customers...” Since Lands’ End Ontario location will not customarily negotiate with his or her customers they cannot be issued a permit under Regulation 1699.

Although it is the opinion of Lands’ End representative that they should be allowed the opportunity to allocate their local tax to Ontario because they fall under Regulation 1802 (a) we are of the opinion that the Ontario location does not comply with Regulation 1699, just as a computer server which a website resides on its own merit may not be issued a seller’s permit as supported in Annotation 710.0013.600.

Annotation 710.0013.600 states that “Orders placed through a retailer’s web site are received by the retailer’s employees located in the City of Hayward. A web site is essentially an electronic forwarding agent from which orders are sent on to the retailer. Under Regulation 1699 (a), the place of sale for local sales tax purposes for orders placed on the Internet would be the jurisdiction where the employee who receives the order is located.” Thus, place of sale for this transaction would be the City of Hayward. The location of the web server is immaterial. It is our position that 1) the credit approval location in Ontario meets the same criteria and 2) it is immaterial that a second credit approval must be conducted before the order is processed. This argument is further supported in Regulation 1802 (a) (2) (B).

Regulation 1802 (a) (2) (B) was established to determine if there was more than one place of sales in this state. It was also created to address the issue of place of sale where 1802 (a) (1) did not have to clarify the issue regarding the participation of the sale. It is here where we more clearly define the intent and spirit of the Bradley Burns Act as it relates to the place of sale. 1802 (a) (2) (B) States “If a retailer has more than one place of business in this state which participates in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this is the place where the order is taken, **it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment or billing.** (emphasis added) For the purpose of this regulation, an employee’s activities will be attributed to the place of business out of which he or she works.

It is here in Regulation 1802 (a) (2) (B) where the key elements are clarified to where the place of sale occurs. First, there must be a principal negotiation at this site. Second, it must be the place where the order is taken. Finally, it is immaterial that the order must be forwarded elsewhere for approval of credit. This Regulation clearly illustrates to us that Lands’ End position does not comply with the position that cities have supported and operated under since the Bradley Burns Act was implemented.

Although Lands’ End representatives would like us to believe that its proposal would not impact other California cities we know better. Our data research indicates that if the Board supports Lands’ End’s proposal the City of San Jose will lose \$40,000 a year and the top 12 cities in the State would also lose \$260,000 a year. In addition, with financial times being so critical for Special Taxing Jurisdictions we feel this change would have a dramatic impact on their revenues since it would be nearly impossible for BOE auditors

to determine if there are misallocations on transaction and use (“district”) taxes. If the allocations were left in the pools it would be easier for BOE staff to reconcile where the transaction and use (“district”) taxes should be distributed for the Special Taxing Jurisdictions.

We believe the local taxes that Lands’ End generates should continue to be allocated in the county pools where it is administratively feasible to allocate the tax as supported by the City of San Joaquin v. State Board of Equalization (1970) 9 Cal. App.3d 365. In this case the courts found that Board should distribute to each taxing jurisdiction in direct proportion to the reported sales attributed to that jurisdiction.

The City of San Jose recommends that the Board not approve the issuance of a seller’s permit for Lands’ End in the City of Ontario. In addition, we would like to encourage further discussion should the Board see a need to modify or amend any regulations to their current policy on this issue.

Sincerely,

David McPherson
Revenue Auditor

cc: Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable John Chiang, Member, Fourth District
Honorable Steve Westly, State Controller, c/o Ms. Marcy Jo Mandel
Mr. Jeffrey L. McGuire, Tax Policy Division (MIC 92)