

# Drop Shipments

This publication is intended for California retailers and will explain the application of tax to drop shipment transactions, including who owes the tax and why.

## What is a drop shipment?

A drop shipment is the delivery of tangible personal property by a California retailer on behalf of an out-of-state retailer to a consumer in California. If you make a drop shipment to a California consumer, you are responsible for reporting and paying sales tax on the retail selling price if:

- The sale is on behalf of an out-of-state retailer, and
- The out-of-state retailer does not hold a California seller's permit or a California Certificate of Registration-Use Tax.

Typically, drop shipment transactions involve two businesses, two sales, and one consumer:

- The *true retailer* is an out-of-state business that is not registered to collect California tax. The true retailer sells the product to the California consumer.
- The *drop shipper* sells the product to the true retailer, but ships the product directly to the California consumer on behalf of the true retailer.
- The *consumer* in California buys and receives the product.

## Who is liable for the tax when a California retailer delivers a product on behalf of an out-of-state retailer?

When an out-of-state retailer holds a valid California seller's permit or a California Certificate of Registration-Use Tax, the out-of-state retailer is liable for tax due on any sale made in California, even if the product is delivered by another California retailer. However, if the out-of-state retailer does not hold a seller's permit or certificate of registration-use tax and the retail sale of the property is subject to California sales or use tax, the California retailer (drop shipper) is liable for the tax.

### Example

A California consumer orders and pays for a doghouse from ABC Supplies (ABC), an out-of-state retailer who is not registered to collect and pay California sales or use tax. ABC buys the doghouse from XYZ, a California retailer, and directs them to deliver it to the California consumer. XYZ delivers the doghouse directly to the California consumer on behalf of ABC. XYZ is the drop shipper and is liable for the sales tax due on the transaction because ABC is not registered to collect tax in California.

## How does the drop shipper calculate the amount of tax due?

The retail amount subject to tax of a drop-shipped item is one of the following:

- The amount the out-of-state retailer charged the California consumer (if known), or

## Sales and Use TAX FACTS

Publication 121 • LDA

For additional information you may download regulations, forms and publications from our website or you may call our Taxpayer Information Section to talk to a Board of Equalization representative.

BOE website and Board Member contact information:  
[www.boe.ca.gov](http://www.boe.ca.gov)

Taxpayer Information Section  
800-400-7115  
TDD/TTY 800-735-2929

Taxpayers' Rights Advocate  
888-324-2798



### BOARD OF EQUALIZATION MEMBERS (Names Updated 2009)

RAMON J. HIRSIG  
Executive Director

BETTY T. YEE  
First District  
San Francisco

BILL LEONARD  
Second District  
Ontario/Sacramento

MICHELLE STEEL  
Third District  
Rolling Hills Estates

JEROME E. HORTON  
Fourth District  
Los Angeles

JOHN CHIANG  
State Controller

- The amount the California retailer (drop shipper) charged the out-of-state retailer plus a mark-up of 10 percent.

If the drop shipper knows the retail selling price the true retailer charged to the consumer, the drop shipper must calculate and report tax based upon that amount. However, a drop shipper may not know the retail selling price of the property paid by the California consumer to the true retailer. In this case, a drop shipper may calculate tax on the retail selling price of its merchandise to the true retailer plus a mark-up of 10 percent. A drop shipper may use a lower mark-up percentage if the drop shipper can document the lower mark-up accurately reflects the selling price charged by the true retailer to the California consumer.

### **Example**

If the drop shipper knows the California consumer purchased the merchandise for \$250, tax should be based on that amount. However, if a drop shipper charges a true retailer \$200 and does not know the selling price to the California consumer, the drop shipper should report and pay tax on a retail selling price of \$220 (\$200 +10% markup of \$20 = \$220).

### **What if the drop shipment involves more than one California retailer?**

It is not uncommon for drop shipments to involve more than one retailer. Generally, the *first* retailer engaged in business in California (the in-state retailer that receives the order from the out-of-state retailer) in the series of drop shipment transactions is liable for the sales tax. The first retailer knows the selling price to the true retailer and must report tax accordingly.

### **Example**

ABC Supplies (ABC), an out-of-state retailer who is not registered to collect and pay California use tax, sells a doghouse to a California consumer. ABC then buys the doghouse from XYZ, a California retailer, and directs them to ship the doghouse to the California consumer. However, XYZ does not have a doghouse in stock and must buy one from 123, who is also a California retailer. XYZ directs 123 to deliver the item to the California consumer.

XYZ is the first retailer (drop shipper) and owes the sales tax even though 123 (second drop shipper) is engaged in business in California. XYZ is the *first* California retailer engaged in the series of drop shipment transactions beginning with the purchase by the true retailer (ABC).

### **Who does the drop shipper charge for sales tax?**

If the out-of-state retailer holds a permit, it should issue the drop shipper a resale certificate for the sale and the drop shipper is relieved of the responsibility to report and pay the tax. However, if the true retailer does not hold a permit, the drop shipper is responsible for reporting and paying the tax. Tax should be charged to the true retailer and reported by the California drop shipper. The true retailer may choose to collect the tax reimbursement from the end consumer.

*Note:* If you drop ship merchandise to a California customer who is buying the property for resale, you may not be liable for tax. You must obtain a valid California resale certificate from the customer and keep it in your records.

This publication does not apply to deliveries of vehicles, vessels, or aircraft. For information on those items, see Regulation 1610, *Vehicles, Vessels, and Aircraft*, Regulation 1620, *Interstate and Foreign Commerce*, and publication 34, *Motor Vehicle Dealers*.

Additional information is available from our website at [www.boe.ca.gov](http://www.boe.ca.gov) or from our Taxpayer Information Section at 800-400-7115.

*Note: This publication summarizes the law and applicable regulations in effect when the publication was written, as noted on the cover. However, changes in the law or in regulations may have occurred since that time. If there is a conflict between the text in this publication and the law, decisions will be based on the law and not on this publication.*