Rulemaking File Index

Title 18. Public Revenue

Sales and Use Tax
Regulation 1684 *Collection of Use Tax by Retailers*

OAL Approval

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State of California
Office of Administrative Law

In re: **Board of Equalization**	**NOTICE OF APPROVAL OF REGULATORY ACTION**
Regulatory Action:	**Government Code Section 11349.3**
Title 18, California Code of Regulations	**OAL File No. 2012-0614-02 S**
Adopt sections: **Amend sections: 1684** **Repeal sections:**	

This rulemaking by the Board of Equalization amends section 1684 of title 18 of the California Code of Regulations. This amendment implements Revenue and Taxation Code section 6203, as amended by Assembly Bill No. 155 (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 9/15/2012.

Date: 7/27/2012

Eric Partington
Staff Counsel

For: DEBRA M. CORNEZ
Director

Original: Kristine Cazadd
Copy: Richard Bennion

RECEIVED
JUL 31 2012
by EXECUTIVE DIRECTOR'S OFFICE
STATE BOARD OF EQUALIZATION

STATE OF CALIFORNIA EDMUND G. BROWN, Jr., Governor

OFFICE OF ADMINISTRATIVE LAW
300 Capitol Mall, Suite 1250
Sacramento, CA 95814
(916) 323-6225 FAX (916) 323-6826

DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk
DATE: 7/30/2012
RE: Return of Approved Rulemaking Materials
OAL File No. 2012-0614-02S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2012-0614-02S regarding Collection of Use Tax by Retailers).

If this is an approved file, it contains a copy of the regulation(s) stamped "ENDORSED APPROVED" by the Office of Administrative Law and "ENDORSED FILED" by the Secretary of State. The effective date of an approved file is specified on the Form 400 (see item B.5). (Please Note: The 30th Day after filing with the Secretary of State is calculated from the date the Form 400 was stamped "ENDORSED FILED" by the Secretary of State.)

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "....no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

STATE OF CALIFORNIA - OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATION SUBMISSION

(See instructions on reverse)

STD. 400 (REV. 01-09)

For use by Secretary of State only

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-	2012-0614-02 S	

For use by Office of Administrative Law (OAL) only

2012 JUN 14 P 1:05

OFFICE OF ADMINISTRATIVE LAW

2012 JUL 27 PM 4:13

NOTICE | REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY: State Board of Equalization

AGENCY FILE NUMBER (If any):

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE | TITLE(S) | FIRST SECTION AFFECTED | 2. REQUESTED PUBLICATION DATE

3. NOTICE TYPE: ☐ Notice re Proposed Regulatory Action ☐ Other | 4. AGENCY CONTACT PERSON | TELEPHONE NUMBER | FAX NUMBER (Optional)

OAL USE ONLY — ACTION ON PROPOSED NOTICE: ☐ Approved as Submitted ☐ Approved as Modified ☐ Disapproved/ Withdrawn | NOTICE REGISTER NUMBER | PUBLICATION DATE

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S): Collection of Use Tax by Retailers

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S):

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT:

AMEND: 1684

REPEAL:

TITLE(S): 18

3. TYPE OF FILING

- ☒ Regular Rulemaking (Gov. Code §11346)
- ☐ Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)
- ☐ Emergency (Gov. Code, §11346.1(b))
- ☐ Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.
- ☐ Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)
- ☐ Emergency Readopt (Gov. Code, §11346.1(h))
- ☐ File & Print
- ☐ Other (Specify)
- ☐ Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
- ☐ Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1): per agency request

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)
- ☐ Effective 30th day after filing with Secretary of State
- ☐ Effective on filing with Secretary of State
- ☐ §100 Changes Without Regulatory Effect
- ☒ Effective other (Specify): 9/15/2012

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY
- ☐ Department of Finance (Form STD. 399) (SAM §6660)
- ☐ Fair Political Practices Commission
- ☐ State Fire Marshal
- ☐ Other (Specify)

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
Richard E. Bennion	(916) 445-2130	(916) 324-3984	rbennion@boe.ca.gov

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE: [signature] | DATE: June 14, 2012

TYPED NAME AND TITLE OF SIGNATORY: Joann Richmond, Chief, Board Proceedings Division

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

JUL 27 2012

Office of Administrative Law

Final Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1684

Section 1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances~~this state is a "retailer engaged in business in this state" and~~ the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee); or~~.~~

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a

person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and

links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by ~~an out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a

substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(3~~b~~) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(A~~1~~) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(B~~2~~) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~f~~f) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~g~~e) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~h~~f) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

formation relevant to the evidence of carcinogenicity of C.I. Disperse Yellow 3. The data call–in period for C.I. Disperse Yellow 3 opened on November 19, 2011 and closed on January 10, 2012. The data call–in period for 2,6–dimethyl–N–nitrosomorpholine opened on February 11, 2011 and closed on April 12, 2011. No information was received on 2,6–dimethyl–N–nitrosomorpholine.

Copies of the documents are available from OEHHA's web site at the following address: **http://www.oehha.ca.gov/prop65.html**. The documents may also be requested from OEHHA's Proposition 65 Implementation Office by calling (916) 445–6900.

This notice marks the beginning of a 60–day public comment period on these two documents. **OEHHA must receive comments and any supporting documentation by 5:00 p.m. on Tuesday, October 9, 2012.** We encourage you to submit comments in electronic form, rather than in paper form. Comments transmitted by e–mail should be addressed to P65Public.Comments@oehha.ca.gov. Comments submitted in paper form may be mailed, faxed, or delivered in person to the addresses below:

Mailing Address:
Ms. Cynthia Oshita
Office of Environmental Health Hazard Assessment
P.O. Box 4010, MS–19B
Sacramento, California 95812–4010

Fax:
(916) 323–8803

Street Address:
1001 I Street
Sacramento, California 95814

OEHHA will organize and index the comments received and forward the information to the CIC members prior to the meeting at which the chemicals will be considered. Comments will also be posted on the OEHHA web site in advance of the meeting.

SUMMARY OF REGULATORY ACTIONS

REGULATIONS FILED WITH SECRETARY OF STATE

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653–7715. Please have the agency name and the date filed (see below) when making a request.

File# 2012–0614–01
AIR RESOURCES BOARD
Vapor Recovery Equipment Defects List

This regulatory action updates the Vapor Recovery Equipment Defects List, which is incorporated by reference in section 94006(b). This list is updated every three years pursuant to Health and Safety Code section 41960.2(c)(2). These updates: 1) include defects for equipment certified in Executive Orders signed since the last amendment to the list; 2) add new defect verification procedures; and 3) make editorial changes for clarity and consistency.

Title 17
California Code of Regulations
AMEND: 94006
Filed 07/26/2012
Effective 08/25/2012
Agency Contact: Trini Balcazar (916) 445–9564

File# 2012–0614–02
BOARD OF EQUALIZATION
Collection of Use Tax by Retailers

This rulemaking by the Board of Equalization amends section 1684 of title 18 of the California Code of Regulations. This amendment implements Revenue and Taxation Code section 6203, as amended by Assembly Bill No. 155 (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013.

Title 18
California Code of Regulations
AMEND: 1684
Filed 07/27/2012
Effective 09/15/2012
Agency Contact:
Richard E. Bennion (916) 445–2130

File# 2012–0726–02
CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE
Administration of CA's Limited Tax–Exempt Debt Authority

The California Debt Limit Allocation Committee (CDLAC) readopted an emergency regulation that amended section 5052 of title 4 of the California Code of Regulations to allow the full refund of the performance deposit if 80% or more of the Allocation is used to issue bonds or issue at least one (1) Mortgage Credit Certificate prior to the expiration date.

Rulemaking File Index

Title 18. Public Revenue

Sales and Use Tax
Regulation 1684 *Collection of Use Tax by Retailers*

1. Final Statement of Reasons
2. Updated Informative Digest
3. Business Tax Committee Minutes, February 28, 2012
    - Minutes and Proposed Text
    - BTC Agenda
    - Formal Issue Paper 12-003
    - Exhibit 1 Revenue Estimate
    - Exhibit 2 Staff Proposed Amendments to Regulation 1684
    - Exhibit 3 Submission from Internet Alliance, Netchoice, AOL, Inc., Yahoo!, Inc., and Google, Inc.
    - Exhibit 4 Submission from Sutherland Asbill & Brennan LLP
    - Exhibit 5 Submission from Muniservices, LLC
    - Regulation History
4. Reporter's Transcript Business Taxes Committee, February 28, 2012
5. Estimate of Cost or Savings, April 6, 2012
6. Economic and Fiscal Impact Statements, March 27, 2012
7. Notice of Publications
    - Form 400 and Notice, Publication Date April 6, 2012
    - Proposed Text of Regulation 1684
    - Email sent to Interested Parties, April 6, 2012
    - CA Regulatory Notice Register 2012, Volume No. 14-Z
8. Notice to Interested Parties, April 6, 2012

    The following items are exhibited:

    - Notice of Hearing
    - Initial Statement of Reasons
    - Proposed Text of Regulation 1684
    - Regulation History
9. Statement of Compliance
10. Public Comment Albin C. Koch, May 29, 2012
11. Reporter's Transcript, Item F1, May 30, 2012
12. Draft Minutes, May 30, 2012, and Exhibits
    - Notice of Proposed Regulatory Action
    - Initial Statement of Reasons
    - Proposed Text of Regulation 1684
    - Regulation History

VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on June 14, 2012 and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

June 14, 2012

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

Final Statement of Reasons for

Adoption of Proposed Amendments to California Code of Regulations,

Title 18, Section 1684, *Collection of Use Tax by Retailers*

Update of Information in the Initial Statement of Reasons

The factual basis, specific purpose, and necessity for, and the anticipated benefits from, the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers,* are the same as provided in the initial statement of reasons.

The adoption of the proposed amendments to Regulation 1684 was not mandated by federal law or regulations and there is no federal regulation that is identical to Regulation 1684.

The State Board of Equalization (Board) did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting the amendments to Regulation 1684 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business and the Board's economic impact analysis, which determined that the Board's proposed regulatory action:

- Will neither create nor eliminate jobs in the State of California;
- Nor result in the elimination of existing businesses;
- Nor create or expand business in the State of California; and
- Will not affect the health and welfare of California residents, worker safety, or the state's environment.

The proposed amendments may affect small business.

Notice of Correction

The Statement of Specific Purpose and Necessity in the initial statement of reasons correctly provides that the "Board considered Formal Issue Paper 12-003 during its February 28, 2012, Business Taxes Committee meeting, and the Board voted to propose the adoption of staff's recommended amendments" to Regulation 1684 at that time. However, the Informative Digest/Policy Statement Overview provided in the notice of proposed regulatory action published in the April 6, 2012, edition of the California Regulatory Notice Register (Register 2012, No. 14-Z, Page 456) contains the following paragraph, which incorrectly indicates that the Board considered the issue paper and voted to propose the amendments to Regulation 1684 during a Business Taxes Committee meeting on February 28, 2011, instead of February 28, 2012:

> During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.)

The Board posted a notice of correction regarding the typographical errors in the notice of proposed regulatory action on its website on May 29, 2012, and Board staff noted the errors and correct date during the public hearing on May 30, 2012.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of the proposed amendments to Regulation 1684 does not impose a mandate on local agencies or school districts.

Public Comments

The Board received written comments regarding the proposed amendments to Regulation 1684 from Mr. Albin C. Koch, via a letter dated May 29, 2012. In his written comments, Mr. Koch recommended that the Board "consider expanding the rebuttable presumption in proposed Regulation 1684 (b) to recognize that all, or at least most, large remote retailers selling to California purchasers via the internet, catalogs, or telephonically do so via 'sales on approval' under which, in accordance with present regulation 1628 (b) (3) (D), they continue to own the goods being sold until after their delivery to and acceptance by California purchasers. Thus, at least such large remote retailers should be considered to have substantial physical presence and 'substantial nexus' within the state of California and therefore be liable to collect and remit use tax from their purchasers in accordance with RTC § 6203, as amended by AB 155." Mr. Koch also recommended that the Board add the following sentence to the end of proposed Regulation 1684, subdivision (b)(3):

> A retailer will be regarded as having a physical presence in California if it makes substantial sales to California purchasers that constitute "sales on approval" within the meaning of existing Regulation 1628 (b)(3)(C).

Mr. Koch subsequently appeared at the public hearing regarding the adoption of the proposed amendments to Regulation 1684 on May 30, 2012. Mr. Koch expressed his full support for the Board's proposed amendments, and the (above) sentence Mr. Koch recommended adding to the regulation. He also explained that a remote seller making a sale on approval to a California customer still owns the property at the time it is delivered

in California, and that, in his opinion, this could create substantial nexus for a large retailer.

Commercial Code section 2326 defines the term sale on approval narrowly and explains that the delivery of goods to a consumer is a sale on approval only if the consumer has the right to return the goods, even if they conform to the contract. Further, the California Court of Appeal has held that "the general presumption runs against a delivery to a consumer as being a sale on approval" and that the fact that an industry accepts returns does not convert "ordinary retail sales contracts into 'sales on approval.'" (*Wilson v. Brawn of California, Inc.* (2005) 132 Cal.App.4th 549, 558.) Instead, the Court of Appeal has held that section 2326 only "addresses transactions where the parties intend the goods in question to continue to be the seller's property after the buyer takes possession of them . . . " and the purpose of a sale on approval is to give the buyer the ability to "use the goods" and the "option to purchase" the goods after a reasonable period of time. (*Ibid.*)

During the May 30, 2012, public hearing, Board staff expressed its opinion that it is not necessary for the Board to specifically address sales on approval in Regulation 1684 because the Board's Legal Department does not believe that out-of-state retailers are making significant amounts of sales on approval to California customers due to the nature of such sales. Board staff expressed its opinion that the sentence Mr. Koch recommended adding to Regulation 1684 might create confusion, rather than clarify the regulation or aid in the Board's administration of the proposed amendments, because:

- The Board's Legal Department does not agree that an out-of-state retailer that makes a sale on approval to a California customer necessarily has a substantial nexus with California; and
- Adding the suggested sentence to Regulation 1684 would create the inference that retailers making sales on approval to California customers have a substantial nexus with California and are therefore required to register to collect California use tax.

Board staff also explained that the rebuttable presumption being added to Regulation 1684, subdivision (b)(2) applies to all retailers with a physical presence in California and the Board can determine whether a retailer that is actually making sales on approval to California customers has a physical presence in and/or a substantial nexus with California if and when the issue is actually raised.

In addition, Mr. Fran Mancia appeared at the May 30, 2012, public hearing on behalf of MuniServices, LLC, and expressed support for the adoption of the Board's proposed amendments to Regulation 1684 and the collaborative interested parties process that produced the proposed amendments.

At the conclusion of the May 30, 2012, public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1684 without any changes. No other

interested parties submitted written comments regarding the proposed amendments to Regulation 1684 and no other interested parties asked to speak at the public hearing.

Determinations Regarding Alternatives

By its motion, the Board determined that no alternative to the proposed amendments to Regulation 1684 would be more effective in carrying out the purposes for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

Furthermore, the Board did not reject any reasonable alternatives to the proposed amendments to Regulation 1684 that would lessen any adverse impact the proposed amendments may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed amendments. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action. Although Mr. Koch did recommend amendments to Regulation 1684, his amendments were additions to the Board's proposed amendments, not alternatives, and Mr. Koch did not present any evidence to indicate that his recommended amendments would lessen the adverse economic impact of the Board's proposed amendments on small businesses or that his recommended amendments would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

In addition, the Board's proposed amendments are anticipated to provide the following benefits:

1. Ensure that Regulation 1684 is consistent with the provisions of new section 6203 (as added by § 3 of Assem. Bill No. 155 (Stats. 2011, ch. 313)), when new section 6203 becomes operative;
2. Give needed guidance to retailers as to whether their activities create a "substantial nexus" with California and will require them to register with the Board to collect use tax when new section 6203 becomes operative;
3. Ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, *Quill Corporation v. North*

Dakota (1992) 504 U.S. 298, *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, *National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, and *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179; and

4. Ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently.

Updated Informative Digest for

Adoption of Proposed Amendments to California Code of Regulations,

Title 18, Section 1684, *Collection of Use Tax by Retailers*

On May 30, 2012, the State Board of Equalization (Board) held a public hearing on and unanimously voted to adopt the original text of the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers,* described in the notice of proposed regulatory action. There have not been any changes to the applicable laws or the effect of the adoption of the proposed amendments to Regulation 1684 described in the informative digest included in the notice of proposed regulatory action. The Board received written comments from Mr. Albin C. Koch regarding the proposed amendments to Regulation 1684. Also, Mr. Koch and Mr. Fran Mancia appeared at the public hearing on May 30, 2012, and commented on the proposed amendments. Mr. Koch's and Mr. Mancia's comments are summarized and responded to below and in the final statement of reasons.

The informative digest included in the notice of proposed regulatory action provides:

"Existing Federal Law Regarding the Collection of State Use Tax

"Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to 'regulate Commerce with foreign Nations, and among the several States' (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a 'substantial nexus' with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a 'physical presence' in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a 'safe harbor' prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

"Further, the United States Supreme Court has historically agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's 'connection with the taxing state is not exclusively by means of the instruments of interstate commerce.' (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to 'departmentalize' its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has 'property within [the taxing] State.' (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

"In addition, the California Supreme Court previously held that 'the slightest [physical] presence' in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556); and the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.) (The initial statement of reasons contains a more detailed discussion of federal and state case law regarding substantial nexus.)

"Current California Law Regarding the Collection of Use Tax

"Currently, RTC sections 6203 and 6226 collectively require a 'retailer engaged in business in this state' to register with the Board and collect California use tax from its California customers. Also, RTC section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. Regulation 1684 requires '[r]etailers engaged in business in this state as defined in Section 6203' to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board, as required.

"Currently, the operative provisions of RTC section 6203, subdivision (c)(1) through (3), define the term 'retailer engaged in business in this state' by providing that:

> '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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

"The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, 'engaged in business in this state' does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e), provide that a retailer is not a 'retailer engaged in business in this state' if that retailer's 'sole physical presence in this state' is to engage in limited convention and trade show activities, as specified.

"Currently, Regulation 1684 does not define the full scope of the phrase 'retailer engaged in business in this state,' as defined in RTC section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase 'retailer engaged in business in this state,' as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a 'retailer engaged in business in this state' and is required to collect the tax at the time rentals are paid by his lessee.

> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not 'engaged in business in this state' based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, 'ultimate owner' means a stock holder, bond holder, partner, or other person holding an ownership interest.

Currently, Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e), regarding convention and tradeshow activities.

"RTC Section 6203 as Amended by AB 155

"RTC section 6203, subdivision (c), as amended by AB 155, will define the term 'retailer engaged in business in this state' more broadly then current section 6203, subdivision (c), and provide that the term means 'any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty.'

"RTC section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term 'retailer engaged in business in this state' specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that 'retailer engaged in business in this state' specifically includes, but is not limited to, any retailer that is a member of a 'commonly controlled group,' as defined in RTC section 25105, and is a member of a 'combined reporting group,' as defined by the Franchise Tax Board (FTB) in Regulation 25106.5, subdivision (b)(3), 'that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . .'

"In addition, subdivision (c)(5)(A), as added to RTC section 6203 by AB 155, will provide that the term 'retailer engaged in business in this state' specifically includes, but is not limited to '[a]ny retailer entering into an agreement or agreements under which a

person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise,' but only if: (1) 'The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)'; and (2) 'The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000).'

"However, subdivision (c)(5)(B), as added to RTC section 6203 by AB 155, will provide that: 'An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property.' Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: 'Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.' Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), 'retailer' includes 'an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code.' Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) 'shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution.'

"Finally, it should be noted that the amendments made to RTC section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the 'taking of orders from customers in this state through a computer telecommunications network,' and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

"The amendments made to RTC section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

"Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1684

"Board staff conducted meetings with interested parties on October 31 and December 20, 2011, in Sacramento, California, and November 2 and December 22, 2011, in Culver City, California, to discuss the effect of the amendments made to RTC section 6203 by AB 155 and how to best amend Regulation 1684 to make it consistent with the amendments to section 6203, implement the new provisions that were added to RTC section 6203 regarding 'substantial nexus,' 'commonly controlled group nexus,' and 'affiliate nexus,' and provide notice to retailers that AB 155 will require retailers to register to collect California use tax if they have a 'substantial nexus' with California.

"After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of RTC section 6203, subdivision (c), as amended by AB 155, providing that 'retailer engaged in business in this state' means 'any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty,' and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;

- Clarify that the phrases 'commission or other consideration' and 'commissions or other consideration that is based upon sales of tangible personal property,' as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any 'consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise';
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California;
- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5), by utilizing contractual terms and factual certifications; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms 'advertisement,' 'solicit,' and 'solicitation' for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Define the term 'person' by reference to the definition of 'person' set forth in RTC section 6005 and define the term 'individual' to mean a 'natural person' for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

"During its February 28, [2012],[1] Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding 'substantial nexus,' 'commonly controlled group nexus,' and 'affiliate nexus,' and providing notice to retailers that they will be required to register to collect California use tax if they have a 'substantial nexus' with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, [2012], meeting are discussed in more detail in the initial statement of reasons.) The proposed amendments are anticipated to provide the following specific benefits:

- Ensure that Regulation 1684 is consistent with the amendments made to section 6203 by AB 155 when the amendments made to section 6203 become operative;
- Ensure that the amendments made to section 6203 by AB 155 are interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Scripto*, and *National Geographic Society*;
- Ensure that section 6203's new affiliate nexus provisions will be interpreted and administered consistently;
- Provide guidance to retailers as to whether their activities create a 'substantial nexus' with California and require them to register with the Board to collect use tax; and
- Provide more certainty to retailers regarding their new use tax collection obligations before the amendments made to section 6203 by AB 155 becomes operative.

"The Board has performed an evaluation of whether the proposed amendments to Regulation 1684 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1684 is the only state regulation prescribing retailers' obligations to collect California use tax. In addition, there is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1684."

Written Public Comments

The Board received written comments regarding the proposed amendments to Regulation 1684 from Mr. Albin C. Koch, via a letter dated May 29, 2012. In his written comments, Mr. Koch recommended that the Board "consider expanding the rebuttable presumption in proposed Regulation 1684 (b) to recognize that all, or at least most, large remote

[1] The informative digest contained in the notice of proposed regulatory action incorrectly referred to a February 28, 2011, Business Taxes Committee meeting, instead of the February 28, 2012, Business Taxes Committee meeting where the Board voted to propose the amendments to Regulation 1684, as noted in notice of correction posted on May 29, 2012, and the final statement of reasons. The typographical errors in the informative digest have been corrected in the updated informative digest.

retailers selling to California purchasers via the internet, catalogs, or telephonically do so via 'sales on approval' under which, in accordance with present regulation 1628 (b) (3) (D), they continue to own the goods being sold until after their delivery to and acceptance by California purchasers. Thus, at least such large remote retailers should be considered to have substantial physical presence and 'substantial nexus' within the state of California and therefore be liable to collect and remit use tax from their purchasers in accordance with RTC § 6203, as amended by AB 155." Mr. Koch also recommended that the Board add the following sentence to the end of proposed Regulation 1684, subdivision (b)(3):

> A retailer will be regarded as having a physical presence in California if it makes substantial sales to California purchasers that constitute "sales on approval" within the meaning of existing Regulation 1628 (b)(3)(C).

Public Hearing

On May 30, 2012, the Board held a public hearing regarding the adoption of the proposed amendments to Regulation 1684. Mr. Koch appeared at the public hearing and expressed his full support for the Board's proposed amendments, and the (above) sentence Mr. Koch recommended adding to the regulation. He also explained that a remote seller making a sale on approval to a California customer still owns the property at the time it is delivered in California, and that, in his opinion, this could create substantial nexus for a large retailer.

Commercial Code section 2326 defines the term sale on approval narrowly and explains that the delivery of goods to a consumer is a sale on approval only if the consumer has the right to return the goods, even if they conform to the contract. Further, the California Court of Appeal has held that "the general presumption runs against a delivery to a consumer as being a sale on approval" and that the fact that an industry accepts returns does not convert "ordinary retail sales contracts into 'sales on approval.'" (*Wilson v. Brawn of California, Inc.* (2005) 132 Cal.App.4th 549, 558.) Instead, the Court of Appeal has held that section 2326 only "addresses transactions where the parties intend the goods in question to continue to be the seller's property after the buyer takes possession of them . . . " and the purpose of a sale on approval is to give the buyer the ability to "use the goods" and the "option to purchase" the goods after a reasonable period of time. (*Ibid.*)

During the May 30, 2012, public hearing, Board staff expressed its opinion that it is not necessary for the Board to specifically address sales on approval in Regulation 1684 because the Board's Legal Department does not believe that out-of-state retailers are making significant amounts of sales on approval to California customers due to the nature of such sales. Board staff expressed its opinion that the sentence Mr. Koch recommended adding to Regulation 1684 might create confusion, rather than clarify the regulation or aid in the Board's administration of the proposed amendments, because:

- The Board's Legal Department does not agree that an out-of-state retailer that makes a sale on approval to a California customer necessarily has a substantial nexus with California; and
- Adding the suggested sentence to Regulation 1684 would create the inference that retailers making sales on approval to California customers have a substantial nexus with California and are therefore required to register to collect California use tax.

Board staff also explained that the rebuttable presumption being added to Regulation 1684, subdivision (b)(2) applies to all retailers with a physical presence in California and the Board can determine whether a retailer that is actually making sales on approval to California customers has a physical presence in and/or a substantial nexus with California if and when the issue is actually raised.

In addition, Mr. Fran Mancia appeared at the May 30, 2012, public hearing on behalf of MuniServices, LLC, and expressed support for the adoption of the Board's proposed amendments to Regulation 1684 and the collaborative interested parties process that produced the proposed amendments.

At the conclusion of the May 30, 2012, public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1684 without any changes. No other interested parties submitted written comments regarding the proposed amendments to Regulation 1684 and no other interested parties asked to speak at the public hearing.

BOARD OF EQUALIZATION
BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE BETTY T. YEE, COMMITTEE CHAIR
450 N STREET, SACRAMENTO
MEETING DATE: FEBRUARY 28, 2012, TIME: 10:00 A.M.

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

Title: Proposed amendments to Regulation 1684, *Collection of Use Tax by Retailers*

Issue/Topic:

Request approval and authorization to publish proposed amendments to implement, interpret, and make specific the amendments made to Revenue and Taxation Code section 6203 by section 3 of Assembly Bill No. 155 (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013.

Committee Discussion:

Staff presented the proposed amendments to Regulation 1684. Staff explained that it reviewed the provisions of the statute, case law, letters of intent published in the Assembly Daily Journal, and all interested parties comments to draft the proposed regulatory language and staff's recommendation is based on the best available information to interpret the statute.

Ms. Steel asked staff about the presumption that a retailer is engaged in business in this state if the retailer has any physical presence in this state and commented that it is a tough standard to apply given that it is not clear how a specific retailer can rebut the presumption by showing that it only has a "slight" physical presence. Staff explained that the Supreme Court and case law establishes the test for physical presence and that the determination as to whether the presence is so slight as to prohibit the state from imposing a use tax collection obligation is based on the facts and circumstances because there is no Supreme Court or case law guidelines that establishes a bright line to define slightest physical presence.

Ms. Steel also questioned the need for a retailer's yearly certification, as opposed to a one-time certification and expressed concerns about the cost of administering this requirement. In response, staff explained that the certification process is based, in part, on provisions in the State of New York and while the annual certification is not a requirement, it is intended to discourage retailers from getting one certification at the beginning and ignoring subsequent changes in their affiliates' activities. Staff further explained that the BOE would not incur additional costs to administer the certification requirement.

Ms. Yee indicated she was prepared to support the proposed amendments but had concerns with staff's reliance on the letters of intent as the underlying authority for interpreting whether online referrals are considered advertising, rather than solicitation, when the online referrals are based on algorithmic functions. Ms. Yee explained that technology is changing and she wants to ensure flexibility of the Board to adapt to changes in technology, so that when algorithmic functions are not anonymous and passive, such referrals can be considered solicitations rather than advertising. Mr. Horton agreed and noted that in the regulatory process the Board may exercise authority to modify regulations based on current activities. Ms. Yee indicated that the letters of intent could be acknowledged but they do not have the force of law and staff should not use them as authority for the amendments to the regulation. Therefore, they would not limit the Board's authority to further interpret the statute in the future.

Committee Action:

1. Upon motion by Mr. Horton, seconded by Ms. Yee, the Committee approved and authorized for publication the proposed amendments to Regulation 1684, *Collection of Use Tax by Retailers*.

The vote was as follows:

MEMBER	Horton	Steel	Yee	Mandel
VOTE	**Y**	**N**	**Y**	**Y**

The proposed amendments will become operative when section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3 becomes operative on September 15, 2012 or January 1, 2013. Implementation will take place 30 days after approval by the Office of Administrative Law. A copy of the proposed amendments is attached.

2. Upon motion by Mr. Horton, seconded by Ms. Yee, the Committee directed staff to exclude the letters of intent, as support, in and of themselves, for the proposed amendments.

The vote was as follows:

MEMBER	Horton	Steel	Yee	Mandel
VOTE	**Y**	**N**	**Y**	**Abstained**

/s/ Betty T. Yee

Honorable Betty T. Yee, Committee Chair

/s/ Kristine Cazadd

Kristine Cazadd, Executive Director

BOARD APPROVED

at the February 29, 2012 Board Meeting

/s/ Diane Olson

Diane Olson, Chief
Board Proceedings Division

1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances ~~this state is a "retailer engaged in business in this state" and~~the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee)~~.~~;

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in

California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who

is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online

advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by a~~n out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the

retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(~~b~~3) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(~~1~~A) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(~~2~~B) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~d~~f) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~e~~g) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~f~~h) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

BOARD OF EQUALIZATION

BUSINESS TAXES COMMITTEE MEETING AGENDA

HONORABLE BETTY YEE, COMMITTEE CHAIRWOMAN
450 N STREET, SACRAMENTO - ROOM 121
FEBRUARY 28, 2012 – 10:00 A.M.

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1. Proposed amendments to Regulation 1684, *Collection of Use Tax by Retailers*

   Request approval and authorization to publish the proposed amendments to interpret and make specific the amendments made to RTC section 6203 by section 3 of AB 155 (Stats. 2011, ch. 313) regarding the definition of "retailer engaged in business in this state."

AGENDA — February 28, 2012 Business Taxes Committee Meeting
Regulation 1684, *Collection of Use Tax by Retailers*

Action 1 – Proposed amendments to Regulation 1684, *Collection of Use Tax by Retailers*	
Issue Paper Alternative 1 – Staff Recommendation See Agenda, pages 2 – 10, and Issue Paper Exhibit 2.	**Alternative 1** Approve and authorize publication of staff's proposed amendments to implement, interpret, and make specific the amendments made to Revenue and Taxation Code section 6203 by section 3 of Assembly Bill No. 155 (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013. **OR**
Issue Paper Alternative 2 – Do not amend Regulation 1684.	**Alternative 2** Do not amend the regulation.

AGENDA — February 28, 2012 Business Taxes Committee Meeting
Regulation 1684, *Collection of Use Tax by Retailers*

Action 1 – Staff Recommendation	(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in sSection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor. (b) General Definition and Rebuttable Presumption. (1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c). (2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer. (3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California. (c) Nonexhaustive Examples of Retailers Engaged in Business in this State. (1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

Action 1 – Staff Recommendation	(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or (B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances ~~this state is a "retailer engaged in business in this state" and~~the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee~~).~~; (C) The retailer maintains, occupies, or uses, 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 in California; or (D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products. (2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if: (A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and (B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph: (i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

Action 1 – Staff Recommendation	(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit. (3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that: (A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and (B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000). The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months. For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

Action 1 – Staff Recommendation	(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless: (A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and (B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state. (5) For purposes of paragraph (3): (A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and (B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf. (6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor. (7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

Action 1 – Staff Recommendation	(A) The retailer's agreement: (i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and (ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above; (B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and (C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent. A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year. (8) For purposes of this subdivision: (A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner

Action 1 – Staff Recommendation	ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations. (B) "Individual" means a natural person. (C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. (D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers. (E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers. (F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services. (9) Examples: (A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-

Action 1 – Staff Recommendation	through ads and links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage. (B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage. (C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if: (i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and (ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

AGENDA — February 28, 2012 Business Taxes Committee Meeting
Regulation 1684, *Collection of Use Tax by Retailers*

Action 1 – Staff Recommendation	(d) Exceptions. (1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by ~~an out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state. (2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest. (~~b~~3) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry. Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that: (~~1~~A) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

Action 1 – Staff Recommendation	(~~2~~B) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year. A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities. (~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957. (~~d~~f) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits. (~~e~~g) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state. (~~f~~h) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

AGENDA — February 28, 2012 Business Taxes Committee Meeting

Regulation 1684, *Collection of Use Tax by Retailers*

Action 1 – Staff Recommendation	(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Issue Paper Number **12-003**

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

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Engaged in Business in this State – Obligation to Collect Use Tax

I. Issue

Whether the Board should amend Sales and Use Tax Regulation (Regulation) 1684, *Collection of Use Tax by Retailers*, to implement, interpret, and make specific the amendments made to Revenue and Taxation Code section 6203 (section 6203) by section 3 of Assembly Bill No. 155 (AB 155) (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013?

II. Alternative 1 - Staff Recommendation

Approve and authorize publication of Board staff's recommended amendments to Regulation 1684, as set forth in Exhibit 2. After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommends that Regulation 1684 be amended to:

- Incorporate the new provisions of section 6203, subdivision (c), as amended by AB 155 (new subdivision (c)), providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty";
- Incorporate the non-exhaustive examples of retailers with substantial nexus set forth in new subdivision (c), including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer;
- Explain that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or

acting together for a common purpose or benefit for purposes of the commonly controlled group nexus provisions;

that is based upon sales of tangible personal property," as used in the affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";

- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period to be engaged in business in California under the affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf for purposes of the affiliate nexus provisions;
- Clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor;
- Create a means by which a retailer can effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus by utilizing contractual terms and factual certifications, and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" and conform the definitions for the terms "advertisement," "solicit," "solicitation," "refer" and "referral" to the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal (the statements are included in Exhibit 3, as discussed below);
- Define the terms "person" and "individual" for purposes of applying the affiliate nexus provisions;
- Provide three examples illustrating the application of the affiliate nexus provisions;
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments to Regulation 1684 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Board staff also recommends that the Board:

- Retain the other current provisions of Regulation 1684 regarding the "taking of orders from customers in this state through a computer telecommunications network" based upon the Board's 1997 interpretation of *Quill*; and

- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

For a more detailed explanation of Alternative 1 - Staff's Recommendation, refer to section VI beginning on page 19 of this paper.

III. Other Alternative Considered

Do not amend Regulation 1684.

IV. Background

Current Regulation 1684 and Current Section 6203

Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board.

Current Provisions of Section 6203
Currently, the operative provisions of section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
>
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state. (Current section 6203, subd. (c)(1)-(3).)

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e) provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Current Provisions of Regulation 1684
Currently, Regulation 1684 does not define the full scope of the phrase "engaged in business in this state as defined in Section 6203." Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of "engaged in business in this state" as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e) regarding convention and tradeshow activities.

Section 6203 as Amended by AB 155

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

Section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group" as defined in section 25105 of the Revenue and Taxation Code, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons [e.g., an affiliate or affiliates] in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the

preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

The amendments made to section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

V. Discussion

Physical Presence Test

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);

- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Historically, the United States Supreme Court has agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connections with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

Further, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556). Further, the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.)

More recently, the Court of Appeals of New York (i.e., New York's highest appellate court) explained that, while the "physical presence" test affirmed in *Quill* requires that a retailer have more than the slightest physical presence in a state before that state can require the retailer to collect the state's use tax, the physical presence "does not need to be substantial" and "it may be manifested by the presence in the taxing State of the [retailer's] property or the conduct of economic activities in the taxing State performed by the [retailer's] personnel or on its behalf." (*Orvis Co., Inc., v. Tax Appeals Tribunal of the State of New York et al.* (1995) 86 N.Y.2d 165, 178.) Furthermore, the California Court of Appeal expressly

agreed with and followed the Court of Appeals of New York's construction of the physical presence test in *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179, 1198-1199. And, the California Court of Appeal further explained that activities performed in California by or on behalf of a retailer will be sufficient to satisfy the physical presence test if they enhance the retailer's sales to California customers and significantly contribute to the retailer's ability to establish and maintain a market in California. (*Id.* at p. 1196.)

Commonly Controlled Group Nexus

Board staff is aware that, in *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, the California Court of Appeal concluded that an out-of-state corporate retailer with no stores, solicitors, or property within California does not have a physical presence in California solely because it is acquired by another corporation that is a retailer with a physical presence. However, in that case, the California retailer's activities did not give the out-of-state retailer a physical presence in California because:

- Neither entity was the alter ego or agent of the other for any purpose;
- Neither entity solicited orders for the products of the other, and neither accepted returns of the merchandise of the other or otherwise assisted or provided services for customers of the other;
- Each entity owned, operated, and maintained its own business assets, conducted its own business transactions, hired and paid its own employees, and maintained its own accounts and records;
- Neither entity held itself out to customers or potential customers as being the same as, or an affiliate of, the other;
- Each entity had its own trade name, goodwill, marketing practices and customer lists and marketed its products independently of the other; and
- Neither purchased goods or services from the other. (*Id.* at p. 388.)

Board staff does not believe that the holding in *Current* affects the validity of the provisions of section 6203, subdivision (c)(4), that will become operative on September 15, 2012, or January 1, 2013, which provide that a retailer is engaged in business in California if: (1) the retailer is a member of a commonly controlled group, as defined in section 25105 of the Revenue and Taxation Code; and (2) the retailer is a member of a combined reporting group, as defined in Franchise Tax Board Regulation 25106.5, subdivision (b)(3), that includes "another member of the retailer's commonly controlled group that, ***pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer***, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer." (Emphasis added.)

This is because the United States Supreme Court agreed with the Washington Supreme Court, in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, 250-251, that a retailer has a substantial nexus with a taxing state if there are persons in that state performing activities on behalf of the retailer that enable the retailer to "establish and maintain a market." In 2005, the California Court of Appeal subsequently quoted *Tyler Pipe* before concluding that an out-of-state retailer organized as a limited liability company (LLC) had a substantial nexus with California because a separate corporation, affiliated with the LLC through a common parent, performed activities in California on behalf of the retailer that were significantly associated with the retailer's ability to establish and maintain its California market. (*Borders Online, supra*, 129 Cal.App.4th at pp. 1196, 1197.) Accordingly, Board staff believes that the California Court of Appeal's holding in *Current* would have been different if the in-state

corporation had performed services in California in connection with tangible personal property to be sold by the out-of-state corporation, pursuant to an agreement with or in cooperation with the out-of-state corporation (i.e., if the provisions of section 6203, subdivision (c)(4) (emphasized above) had been operative and satisfied in that case).[1]

Affiliate Nexus

The State of New York has enacted an affiliate nexus statute that is similar to the provisions of section 6203, subdivision (c)(5), as amended by AB 155. The New York statute creates a rebuttable presumption that a retailer is soliciting business in New York through an independent contractor or other representative and is required to register to collect New York use tax if the retailer enters into an agreement with a resident of New York under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the retailer's cumulative gross receipts from sales to customers in New York who were referred to the retailer by residents with the requisite agreements is in excess of $10,000 during the four proceeding quarters. (N.Y. Tax Law § 1101, subd. (b)(8)(vi).) The New York statute also provides that the presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer "that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question." (*Ibid.*)

Amazon.com LLC filed a lawsuit in New York seeking declaratory and injunctive relief on the ground that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; however, when the Supreme Court of New York County (i.e., a New York trial court) denied the relief, Amazon.com LLC dropped its facial challenge and appealed the trial court's decision on other grounds, including the ground that the New York statute allegedly violates the Commerce Clause as applied to Amazon.com LLC. (*Amazon.com, LLC, et al. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.) Overstock.com, Inc. also filed a lawsuit in New York seeking injunctive and declaratory relief on the ground that that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; and when the Supreme Court of New York County denied the relief, Overstock.com, Inc. argued that the statute allegedly violates the Commerce Clause both on its face and as applied to Overstock, Inc. when it appealed the Supreme Court of New York County's decision. (*Overstock.com, Inc. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.)

Amazon.com, LLC's and Overstock.com, Inc.'s appeals were consolidated into one matter before the Appellate Division of the Court of Appeals of New York (i.e., an intermediate appellate court) and jointly decided on November 4, 2010. (2010 N.Y. Slip Opn. 7823.) In that decision, the Appellate Division concluded that the New York statute is consistent with the "physical presence" test, which was affirmed in *Quill* and discussed at length in *Orvis*, because it only requires a retailer to register to collect New York use tax if the retailer enters into a business-referral agreement with a New York resident, the resident actively solicits business in New York, as opposed to merely posting a passive advertisement, and the resident receives a commission based upon the sales successfully solicited in New York. (2010 N.Y. Slip Opn. 7823, at pp. 8-10.)

[1] In its written comments, discussed below, Sutherland Asbill & Brennan LLP disagreed with this statement and asked that it be stricken from a prior discussion paper. However, staff did not strike the statement because staff continues to believe that the provisions of section 6203, subdivision (c)(4), that will become operative on September 15, 2012, or January 1, 2013, are consistent with the holdings in *Tyler Pipe* and *Borders Online*.

Board staff believes that, after remand back to the trial court for further factual development, both Amazon.com, LLC and Overstock.com, Inc. may continue to press their objections to the Appellate Division's decision to the Court of Appeals of New York (i.e., New York's highest appellate court). However, in the meantime, the New York State Department of Taxation and Finance has issued Technical Services Bureau Memorandum TSB-M-08(3)S (May 8, 2008), which explains the rebuttable presumption in the New York statute and provides that the "Tax Department will deem the presumption rebutted where the [retailer] is able to establish that the only activity of its resident representatives in New York State on behalf of the [retailer] is a link provided on the representatives' Web sites to the [retailer's] Web site and none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the [retailer]." And, TSB-M-08(3)S further provides that "an agreement to place an advertisement does not give rise to the presumption"; however, "placing an advertisement does not include the placement of a link on a Web site that, directly or indirectly, links to the Web site of a [retailer], where the *consideration for placing the link on the Web site is based on the volume of completed sales generated by the link.*" (Emphasis added.)

The New York State Department of Taxation and Finance also issued Technical Services Bureau Memorandum TSB-M-08(3.1)S (June 30, 2008), which provides that a retailer may rebut the presumption that it has nexus under the New York statute by meeting both of the following conditions:

1. Contract condition – Showing that the contract or agreement between the retailer and the resident representative provides that the resident representative is prohibited from engaging in any solicitation activities in New York that refer potential customers to the retailer, including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails, and, if the resident representative is an organization (such as a club or a nonprofit group), showing that the contract or agreement also provides that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above; and
2. Proof of compliance condition – Showing that each resident representative has submitted to the retailer, on an annual basis, a signed certification stating that the resident representative has not engaged in any prohibited solicitation activities in New York, as described above, at any time during the previous year, and, if the resident representative is an organization, that the annual certification also include a statement from the resident organization certifying that its Web site includes information directed at its members alerting them to the prohibition against each of the solicitation activities described above.

However, as to the proof of compliance condition, a signed certification from a resident representative may only be used to rebut the presumption in the New York statute if the retailer accepts it in good faith (i.e., the retailer does not know or have reason to know that the certificate is false or fraudulent).

In addition, Board staff is aware that subdivision (a)(1) of Regulation 1540, *Advertising Agencies and Commercial Artists*, provides that: "Advertising is commercial communication utilizing one or more forms of communication (such as television, print, billboards, or the Internet) from or on behalf of an identified person to an intended target audience." Board staff is also aware that, in the administrative appeal of Barnes & Noble.com, LLC, the Board had to determine whether certain in-state activity constituted "advertising" or "selling." In the Memorandum Opinion the Board adopted to decide the Barnes & Noble.com appeal, the Board stated that "an 'advertisement' is a 'written, verbal, pictorial, graphic, etc., announcement of goods or services for sale, employing purchased space or time in print or electronic media.'" However, the Board also concluded that when California employees of Barnes &

Noble Booksellers, Inc. (B&N Booksellers), physically distributed coupons to B&N Booksellers' customers, which could only be used to make discounted purchases from Barnes & Noble.com (B&N.com), the acts of physically distributing the coupons directly to the potential customers of B&N.com were solicitations of those persons, and went beyond mere advertising to the public at large. (Memorandum Opinion, *Barnes & Noble.com*, adopted September 12, 2002.)

Furthermore, Board staff has found that Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) provides that the word "advertise" means "[t]o make known to the public through a medium of publicity that one's goods or services are available for sale or engagement." In addition, Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) defines the word "solicit" as "to invite a business transaction" or "[t]o importune, entreat, implore, ask, attempt, or try to obtain an order" and defines the phrase "solicitation of business" as "seeking orders for goods or services."

Websites

Enactment of Current Section 6203, Subdivision (d)
Statutes 1994, chapter 851 (Assem. Bill No. 72, Klehs (AB 72)), section 2 added a new subdivision (k) to section 6203 to provide as follows:

> (k) (1) For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of on-line communications services other than the displaying and taking of orders for products.
>
> (2) This subdivision shall become inoperative upon the earlier of the following dates:
>
> (A) The operative date of either (i) provisions of S. 1825 of the 103rd Congress of the United States that authorize states to compel the collection of state sales and use taxes by out-of-state retailers or (ii) substantially similar provisions of another Congressional act.
>
> (B) The date five years from the effective date of the act adding this subdivision.

The legislative digest included in the August 30, 1994, Assembly Floor Analysis of AB 72, provides that "Existing law . . . [m]akes a determination regarding whether or not a retailer is doing business in the state (has 'nexus' in the state) based on a number of factors including: physical location in the state; use of agents in the state; or ownership of a related in-state business." The legislative digest further provides that the provisions of subdivision (k)(1) (above) "[e]xclude from the definition of a retailer 'engaged in business in this state' any electronic display of products or receipt of orders on a computer network located in California, if the network is not owned by the retailer" and "specify that the computer network exception applies only to networks that consist substantially of on-line services other than the display and taking of orders for products." The comments section of the August 30, 1994, analysis of AB 72 also explains that:

> Apple Computer is currently developing an on-line home computer network, e.World. The network would like to offer subscribers the ability to shop on-line from Lands End and other direct marketing operations. Apple currently intends to locate the mainframe computer which supports the e.World network in Napa. Subscribers to the network would be connected to the mainframe through modems and phone lines.

> The Board of Equalization has indicated to e.World that because of the mainframe's location in California, the board believes that any retailer advertising on the e.World network should be considered to have nexus in-state. Accordingly, the board argues that retailers advertising on the network should be required to collect sales tax both on sales made through e.World and any other sales to consumers in California.
>
> While e.World does not believe that BOE would be able to enforce this position (e.World believes the computer network functions much like a direct seller phone order system which is not subject to tax), the advi[c]e has had a chilling effect on e.World's ability to attract retailers to advertise on the network. Accordingly, absent some clarification of the law, e.World indicates it will likely be forced to relocate the mainframe system outside the state.
>
> This bill makes clear that a retailer who otherwise would not be required to collect sales tax, would not be required to do so simply because they advertise on a computer network which they do not own.

Revenue and Taxation Code section 6203, subdivision (g), was subsequently deleted and subdivision (k) was renumbered as subdivision (j) by Statutes 1995, chapter 555 (Sen. Bill No. 718), section 7 (before eventually being renumbered as current subdivision (d), which does not contain the original sunset provision).

Adoption of Regulation 1684's Current Website Provisions
The Silicon Valley Software Industry Coalition (Coalition) submitted written comments to the Board for consideration during the July 31, 1997, public hearing regarding proposed amendments to Regulation 1684 to address the use of websites. The Coalition's comments explain that:

> [T]he Governor of New York held a press conference [in early 1997] to announce that the mere presence of a company's web site in their state did not constitute nexus for tax purposes in New York. Unfortunately, New York's governor then went on to specifically state that California web-site hosting companies should leave California and relocate in New York, thus implying that California laws created an opposite result. CommerceNet and the Coalition disagreed with New York['s] interpretation of California's laws and requested the State Board of Equalization to make clear that California's law does not create an incentive for California web-hosting companies to leave California in order to protect their customers from over-reaching tax laws.

As a result of the request, the Board directed staff to prepare a memorandum regarding website nexus and Board staff subsequently submitted Formal Issue Paper 97-005 to the Board for discussion at its April 8, 1997, Business Taxes Committee (BTC) meeting. Formal Issue Paper 97-005 opined that:

> In 1993, we received a request for advice regarding a company contemplating starting an on-line computer service similar to on-line service providers. The host computers for the service would be located in California. The company's plan was to offer retailers of tangible personal property the opportunity to place their catalogs on line to be accessed by the on-line company's customers who could also place orders for such tangible personal property over the on-line service. This selling function would not be the primary function of the on-line service; rather, it would consist substantially of on-line

services other than the displaying and taking of orders for products. The company asked whether retailers using the service in this manner to display their catalogs and accept orders through the on-line service would be regarded as retailers engaged in business in California by virtue of this activity.

The company's plan consisted of acting as the out-of-state retailers' representative in this state through its computers located in this state that were used to display tangible personal property for sale and take orders for such property on the out-of-state retailers' behalf. Thus, the staff's conclusion was that the out-of-state retailers would be "engaged in business" in California under subdivision (b) of Revenue and Taxation Code section 6203 by using the company as their representative in this state for purposes of selling tangible personal property.

The company sought relief from the application of subdivision (b) of section 6203 from the Legislature. In cases such as this, if the Legislature chooses to pass legislation, it can do so in several ways. It can pass a statute that simply reverses the interpretation given to the taxpayer. When it does so, it sometimes does so by making the reversal "declaratory of existing law," indicating an intent that the Legislature's provision be retroactive. The Legislature may just make its reversal prospective. The Legislature may, instead of either of these methods, choose to pass a narrowly tailored provision to apply to very specific circumstances. This is what it did in response to the company's request for relief. The Legislature did not pass an outright reversal of the interpretation that a retailer is engaged in business in California if it uses a computer service which is physically located in California to advertise and take orders for sales of tangible personal property. Instead, in narrowly tailored legislation carried by then Assemblyman Johan Klehs, the Legislature adopted subdivision (j) of section 6203 in 1994. The bill was effective September 27, 1994, but became operative on January 1, 1995. (This provision was originally lettered subdivision (k), but has since been relettered (j).) This provision states:

> (1) For purposes of this section, 'engaged in business in this state' does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. <u>The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of on-line communications services other than the displaying and taking of orders for products.</u> (Emphasis added in original.)
>
> (2) This subdivision shall become inoperative upon the earlier of the following dates:
>
> (A) The operative date of provisions of a congressional act that authorize states to compel the collection of state sales and use taxes by out-of-state retailers.
>
> (B) The date five years from the effective date of the act adding this subdivision.

> This provision applies only to circumstances where the advertising and order-taking is made through a computer telecommunications network which consists substantially of on-line services *other than* the displaying and taking of orders for tangible personal property. Thus, a retailer who displays and takes orders through a computer telecommunications network located in California which does *not* consist substantially of on-line communications services other than the displaying and taking of orders for tangible personal property within the meaning of subdivision (j) of section 6203 arguably should be regarded as engaged in business in California under subdivision (b) of section 6203 (since the subdivision (j) exclusion would not apply). Any other interpretation of subdivision (j) would render it surplusage.
>
> The Legislature effectively stated that this type of activity comes within the definition of "engaged in business" in California of subdivision (b) by adopting a sunset date to the subdivision (j) exclusion to the otherwise applicable provisions of section 6203. Subdivision (j) becomes inoperative in 1999. If this activity did not otherwise come within subdivision (b), there would have been no reason to adopt the narrow subdivision (j) exclusion, nor would there be any reason to have its provisions sunset in 1999. Every provision in a statute must be given meaning whenever possible since the Legislature is presumed not to engage in idle acts. *(Silberg v. Anderson* (1990) 50 Cal.3d 205, 216; *General American Transportation Corp. v. State Bd. of Equalization* (1987) 193 Cal.App.3d 1175, 1181.) Thus, the displaying and taking of orders on a computer located in California brings retailer within subdivision (b) of section 6203. The remaining question is whether the activity comes within the subdivision (j) exclusion from the otherwise applicable provisions of subdivision (b).

However, Mr. Klehs, then Vice Chair of the Board, also distributed his own written comments to the Board on April 8, 1997, for consideration at the BTC meeting that day, which construed the legislative intent underlying the enactment of then subdivision (j). Mr. Klehs' comments provide that "[t]he legislative intent of AB 72 (Klehs-1994) was to give the BOE staff clear guidance that a retailer is not 'engaged in business' in California merely because it maintains a web-site on a third party's computer which is located in this state, as long as the host computer network consists substantially of services other than displaying and taking of orders for products. In other words, products sold through web sites or over the internet should be treated for nexus purposes the same as mail order or telephone sale products."

The minutes from the Board's April 8, 1997, BTC meeting further explain that:

> The members unanimously agreed to direct staff to incorporate, for the Board's consideration to approve publication, the amendment to Regulation 1684 drafted by Dr. Connell and Mr. Andal, with legislative intent provided by Mr. Klehs in the attached memo of April 8, 1997, and support by Mr. Dronenburg for the amending language.
>
> Staff was directed to incorporate the proposed amendment to Regulation 1684 as approved by the members. A draft of those amendments is attached.

The original amendments drafted by Dr. Connell and Mr. Andal provided that: "An out-of-state retailer whose only contact with this state is the use of a computer server on the Internet to create or maintain a World Wide Web page or site does not constitute 'substantial nexus' with this state. No Internet Service Provider, On-line Service Provider or other similar provider of Internet access services or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer solely as a result of the service provider maintaining a web page or site on a computer server that is physically

located in this state." However, during the July 31, 1997, public hearing regarding the adoption of the proposed amendments, the Board directed staff to change the second sentence based upon comments from interested parties so that the second sentence provided that "No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state." The revised amendments were then adopted on September 10, 1997, and remain part of subdivision (a) of Regulation 1684 today.

The Final Statement of Reasons provides the following factual basis for the adoption of the proposed amendments:

> In recent years, two business practices have arisen which raise the issue as to whether or not the retailers practicing them thus became engaged in business in this state. First, some out-of-state retailers have established Web Sites (electronic files maintained on computers called servers) on the World Wide Web, part of the Internet, for the purpose of making sales. The Internet evolved from a Defense Department project in the late 1960's, and has grown to be a world-spanning network of at least 60,000 smaller, independent computer networks linked by satellites, coaxial cable, and phone lines. The World Wide Web is a smaller network of hyperlinked documents within the Internet. (Yahoo! Internet Life (8/97), p. 62) Servers mainly belong to service providers, either Independent Service Providers (ISP's), or national commercial on-line services like Prodigy or America On-Line. The server on which the Web Site is located may or may not be sited in California. Confusion has arisen as to whether or not an in-state ISP who hosts an out-of-state retailer's Web Site is a "representative" within the meaning of Section 6203(b) for use tax collection purposes and, if so, whether the exemption contained in Section 6203(j), whereby nexus is not provided by a retailer's use of an on-line service for the purpose of taking orders for tangible personal property if the primary purpose of the service is not the sale of tangible personal property, applies to a retailer's Web Site carried by a general-interest ISP which hosts a myriad of Web Sites as well as to a proprietary on-line service. Legislation has been introduced to clarify these principles, but none has yet been enacted. As more and more business is being conducted on the Internet, the Board concluded that it was necessary to resolve this issue by regulation to bring some certainty to this area pending legislative action. Upon consultation with industry, the Board concluded that a Web Site is a utility service operating through communications lines to forward a buyer's order to the retailer, so that orders placed through a Web Site should be treated for nexus purposes like orders placed through the mail which the United States Supreme Court has determined does not provide "nexus." (Quill Corporation v. North Dakota (1992) 504 U.S. 298.) The Board also concluded that the Legislature did intend that Section 6302(j) apply to Web Sites hosted by ISP's as well as to proprietary networks.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding the use of websites was based upon the Board's 1997 interpretation of *Quill* and not solely the express language of subdivision (k) of section 6203, as added by AB 72 (currently subdivision (d) of Revenue and Taxation Code section 6203), which will be inoperative on September 15, 2012, or January 1, 2013, due to the provisions of AB 155. However, Board staff is not aware of any published California or federal court case decided before or after 1997 that expressly addresses whether a retailer has substantial nexus with a taxing state when the retailer uses a third party's server in a taxing state or when the retailer

has an Internet Service Provider performing activities on behalf of the retailer in a taxing state. If an out-of-state retailer owns a server in California (as opposed to merely purchasing web services through a third party's servers), under the current (and continuing) provisions of section 6203, subdivision (c)(1), the retailer has a place of business in California where the server is located and is, thus, obligated to collect California use tax. As set forth in more detail below, California's approach to servers is similar to the statutory approaches taken by New York and Washington.

New York's Website Statute
New York's Technical Services Bureau Memoranda TSB-M-97 (1.1)C Corporation Tax and (1.1)S Sales Tax (November 15, 1999) explain that:

> On October 8, 1998, Governor George E. Pataki signed into law new legislation to codify existing state policy with regard to taxation of Internet access, as previously announced in Technical Services Bureau Memoranda TSB-M-97(1)S and TSB-M-97(1)C, which are obsolete and are replaced by this memorandum. This new legislation added sections 12, 179, and 1115(v) to the Tax Law, and is applicable, for sales and compensating use tax purposes, to sales or uses made on or after February 1, 1997.

The provisions of New York Tax Law section 12 provide that:

> (a) For purposes of subdivision (b) of this section, the term "person" shall mean a corporation, joint stock company or association, insurance corporation, or banking corporation, as such terms are defined in section one hundred eighty-three, one hundred eighty-four, or one hundred eighty-six, or in article nine-A, thirty-two or thirty-three of this chapter, imposing tax on such entities.
>
> (b) No person shall be subject to the taxes imposed under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, thirty-two or thirty-three of this chapter, solely by reason of (1) having its advertising stored on a server or other computer equipment located in this state (other than a server or other computer equipment owned or leased by such person), or (2) having its advertising disseminated or displayed on the Internet by an individual or entity subject to tax under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, twenty-two, thirty-two or thirty-three of this chapter.
>
> (c) A person, as such term is defined in subdivision (a) of section eleven hundred one of this chapter, *shall not be deemed to be a vendor, for purposes of article twenty-eight of this chapter, solely by reason of (1) having its advertising stored on a server or other computer equipment located in this state (other than a server or other computer equipment owned or leased by such person), or (2) having its advertising disseminated or displayed on the Internet by an individual or entity subject to tax* under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, twenty-two, thirty-two or thirty-three of this chapter.
>
> (d) (i) Except as provided in clause (B) of subparagraph (ii) of paragraph eight of subdivision (b) of section eleven hundred one of this chapter, *a person selling telecommunication services or an Internet access service shall not be deemed to be a vendor, for purposes of article twenty-eight or twenty-nine of this chapter, of tangible personal property or services sold by the purchaser of such telecommunication services or*

> *Internet access service solely because such purchaser uses such telecommunication services or Internet access service as a means to sell such tangible personal property or services.*
>
> (ii) For purposes of this subdivision, the term "person" shall refer to any person within the meaning prescribed in either paragraph (c) of subdivision one of section one hundred eighty-six-e of this chapter or subdivision (a) of section eleven hundred one of this chapter, the term "telecommunication services" shall have the meaning prescribed in paragraph (g) of subdivision one of section one hundred eighty-six-e of this chapter, and the term "Internet access service" shall have the meaning prescribed in subdivision (v) of section eleven hundred fifteen of this chapter. (Emphasis added.)

In addition, the provisions of New York Tax Law section 12 enacted in 1998 were not amended when New York enacted its affiliate nexus statute discussed above. Therefore, New York's policy permitting out-of-state retailers to use third-party servers located in New York to make sales to customers in New York and permitting Internet Service Providers to provide specified in-state services to out-of-state retailers without being required to register to collect New York use tax has been codified in a statute since 1998.

Washington's Website Statute

Furthermore, in 2003, the State of Washington added a new statute to its use tax laws to address the use of websites by out-of-state retailers. Paragraphs (5) and (6) of section 82.12.040, title 82 of the Code of Washington, have not been substantially amended since their provisions were enacted in 2003 and currently provide that:

> (5) Notwithstanding subsections (1) through (4) of this section, any person making sales is not obligated to collect the tax imposed by this chapter if:
>
> (a) The person's activities in this state, whether conducted directly or through another person, are limited to:
>
> (i) The storage, dissemination, or display of advertising;
>
> (ii) The taking of orders; or
>
> (iii) The processing of payments; and
>
> (b) The activities are conducted electronically via a web site on a server or other computer equipment located in Washington that is not owned or operated by the person making sales into this state nor owned or operated by an affiliated person. "Affiliated persons" has the same meaning as provided in RCW 82.04.424.
>
> (6) Subsection (5) of this section expires when: (a) The United States congress grants individual states the authority to impose sales and use tax collection duties on remote sellers; or (b) it is determined by a court of competent jurisdiction, in a judgment not subject to review, that a state can impose sales and use tax collection duties on remote sellers.

Therefore, Washington's policy permitting out-of-state retailers to use third-party servers located in Washington to make sales to customers in Washington without being required to register to collect Washington use tax has been codified in a statute since 2003.

Warranty and Repair Services

Multistate Tax Commission (MTC) Nexus Program Bulletin 95-1 concludes, based upon an analysis of the United States Supreme Court's opinions, that a retailer has a substantial nexus with a taxing state for purposes of imposing a use tax collection obligation if the retailer is providing warranty and repair services in the taxing state through a third-party service provider. Before the MTC issued Bulletin 95-1, the MTC asked the states whether they agreed that the bulletin correctly reflected federal law and each of the individual state's laws and, if so, whether the MTC could include the states' endorsements in the final bulletin, which would subsequently be issued. Based upon the MTC's request, the Board reviewed Bulletin 95-1, and found that it was consistent with California and federal law. Therefore, during its meeting on October 26, 1995, the Board adopted Bulletin 95-1, which was subsequently issued by the MTC in December 1995 with the support of a coalition of 26 states, including California.

However, Mr. Andal distributed a February 13, 1996, memorandum to the Board Members in which he requested that the Board revisit its decision to adopt Bulletin 95-1 because, in his opinion, the bulletin misconstrued federal law and was not consistent with the provisions of section 6203. The Board directed staff to consider and respond to Mr. Andal's comments, and, in March of 1996, the Sales and Use Tax Department presented an issue paper to the Board which provides staff's opinion that Bulletin 95-1 is consistent with both federal and California law, including section 6203. The issue paper also explains that the Board's approval of staff's interpretation of Bulletin 95-1 did not "bind the Board as would a regulation. That is, if a matter arising under enforcement of staff's interpretation of the proper nexus provisions in this area comes before the Board on a petition for redetermination, the Board will have the opportunity to rule on the matter once again with all of the relevant facts before it."

Thereafter, during its meeting on April 10, 1997, the Board unanimously voted to grant the petition of Airway Scale and Manufacturing Company, Inc., in accordance with Mr. Klehs' opinion that a retailer is not engaged in business in California solely because the retailer uses an in-state independent contractor to perform warranty and repair services on behalf of the retailer. And, during the Board's May 6, 1997, BTC meeting, Mr. Dronenburg made a motion to amend Regulation 1684 to include language he drafted to incorporate the above opinion regarding warranty and repair services and the motion was unopposed. Therefore, staff included Mr. Dronenburg's language with the 1997 amendments to Regulation 1684 regarding websites, Mr. Dronenburg's language was subsequently adopted without changes, and this language still remains part of Regulation 1684, subdivision (a) today.

The Final Statement of Reasons provides the following factual basis for the adoption of the proposed 1997 amendments regarding warranty and repair services:

> [M]any retailers have entered into contracts with instate businesses to perform repair services on such retailers' products purchased by buyers who are residents of this state.
>
> Again, a controversy has arisen as to whether or not these independent contractors are "representatives" of such retailers within the meaning of Section 6203(b) for use tax collection purposes. Upon researching this issue, the Board determined that such repairmen do not qualify under established United States Supreme Court cases as representatives for nexus purposes because they do not participate in the transfer of the

property from the out-of-state retailer to the in-state customer but, rather, become involved with the property after (sometimes long after) the sale transaction is concluded. As more and more out-of-state retailers are out-sourcing their warranty responsibilities to instate independent contractors rather than maintaining in-state repair facilities, and no statute addresses this issue, the Board concluded that it was necessary for it to bring certainty to this issue by regulatory action.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding warranty and repair services was based upon the Board's 1997 interpretation of United States Supreme Court cases. However, Board staff is not aware of any published California or federal court case decided before or after 1997 that expressly addresses whether a retailer is engaged in business in a taxing state solely because the retailer uses an in-state independent contractor to perform warranty and repair services on behalf of the retailer. We further note that the MTC has not withdrawn Bulletin 95-1.

VI. Alternative 1 - Staff Recommendation

Initial Discussion Paper

In the Initial Discussion Paper issued October 14, 2011, Board staff recommended that Regulation 1684 be amended to:

- Incorporate the new provisions of section 6203 regarding substantial nexus, including provisions addressing commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess* (and affirmed in *Quill*) by creating a rebuttable presumption that, unless otherwise provided in Regulation 1684, a retailer is required to collect California use tax if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier or the United States mail or interstate telecommunication;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new provisions of section 6203 by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Explain that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in the new affiliate nexus provisions of section 6203, refer to commissions or other consideration that is based upon completed sales of tangible personal property, similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;
- Create a means by which a retailer can effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203 by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Board staff also recommended that the Board:

- Retain the current provisions of Regulation 1684 regarding the "taking of orders from customers in this state through a computer telecommunications network" based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

Initial Interested Parties Meetings and Comments

Board staff conducted meetings with interested parties on October 31, 2011, in Sacramento, California, and November 2, 2011, in Culver City, California, to discuss the Initial Discussion Paper issued October 14, 2011. Mr. Robert Wils, Mr. Fran Mancia, and Ms. Brenda Narayan of MuniServices, LLC attended the October 31, 2011, meeting and, after the meeting, staff received a written comment from MuniServices, LLC that expressed MuniServices, LLC's support for staff's recommended amendments to Regulation 1684. Ms. Michele Pielsticker of Sutherland Asbill & Brennan LLP also attended the October 31, 2011, meeting and asked staff questions about the differences between advertising and soliciting during that meeting. After the meeting, Sutherland Asbill & Brennan LLP submitted written comments regarding staff's recommended amendments to Regulation 1684. Sutherland Asbill & Brennan LLP's written comments recommended:

- Revising staff's recommended amendments adding subdivision (c)(2) to Regulation 1684 to define the phrase "in cooperation with" so that it only refers to "activities performed directly for or on behalf of a retailer," and clarify that subdivision (c)(2) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that enable the out-of-state retailer to "create or maintain an in-state market";
- Revising staff's recommended amendments incorporating the affiliate nexus provisions into Regulation 1684 in order to: (A) define the phrase "person or persons in this state" so that it only refers to "an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California"; (B) clarify that "creating a sales and use tax collection obligation based on the presence of an in-state person who refers customers must be limited to those in-state persons who are performing activities to establish or maintain a California market"; (C) clarify the phrase "other consideration"; (D) explain what the phrases "directly or indirectly," "indirectly solicit," "indirect solicitation," and "or otherwise" mean with examples; (E) clarify whether "a static link that is labeled 'click here' constitutes a solicitation"; (F) "explain that the method of compensation should not convert an otherwise permissible advertisement into a market-making activity that leads to attributional nexus"; and
- Revising staff's recommended amendments creating a means by which a retailer can effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus by utilizing contractual terms and factual certifications so that retailers are excused from obtaining certificates where it would be impossible to do so, for example, where the in-state person is deceased.

Sutherland Asbill & Brennan LLP's written comments also recommended striking Board staff's recommended amendments to Regulation 1684's website provisions because, in Sutherland Asbill & Brennan LLP's opinion, staff's recommended amendments violate the Internet Tax Freedom Act (ITFA), and striking Board staff's proposed amendments adding subdivision (b)(2) to Regulation 1684 because, in Sutherland Asbill & Brennan LLP's opinion, the rebuttable presumption in subdivision (b)(2) is inconsistent with the United States Supreme Court's view of the Commerce Clause.

Ms. Rebecca Madigan, Executive Director of the Performance Marketing Association, Inc., attended the November 2, 2011, interested parties meeting, and Ms. Madigan made a number of comments regarding the affiliate nexus provisions of section 6203, subdivision (c)(5), as added by AB 155, and staff's initial recommendations to amend regulation 1684 to incorporate those provisions.

First, Ms. Madigan explained that most out-of-state retailers have declined to use New York's procedures for establishing that an advertising agreement with a New York affiliate is not the type of agreement that can create affiliate nexus with New York and cut their ties with their New York affiliates because:

- The direct marketing industry practice is generally to only pay the in-state affiliates commissions based upon completed sales (and with no other compensation) since this is the most cost-effective model for the out-of-state retailers to directly market to in-state customers; and
- The out-of-state retailers are concerned about how they will be treated if and when one of their New York affiliates is found to be soliciting sales in New York in violation of its agreement.

Therefore, Ms. Madigan made a general suggestion that staff consider revising its recommended amendments creating a means by which a retailer can effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus by utilizing contractual terms and factual certifications so that the amendments do not prohibit an advertising agreement from providing for the payment of commissions based upon completed "click-through" sales.

Second, Ms. Madigan explained that the direct marketing industry generally operates through third-party intermediaries. This means that most retailers hire third-party intermediaries whose jobs are to hire the retailers' in-state direct marketing affiliates based upon the terms provided by the retailers, and then track and pay the affiliates' commissions in return for their own percentage of the completed sales generated by the affiliates. Ms. Madigan also explained that one of the largest third-party intermediaries is Commission Junction, Inc., which has its headquarters in California. She further stated that she thought Commission Junction, Inc., would likely leave the state if staff concluded that its intermediary activities can create affiliate nexus for its customers.

In addition, staff received a written comment from the Internet Alliance, NetChoice, AOL, Inc., Yahoo!, Inc., and Google, Inc., which noted that Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner published statements of intent in the September 9, 2011, Assembly Daily Journal, which clarified that the provisions of section 6203, subdivision (c)(5)(A)-(C), were intended to:

> [D]raw a clear line between activities that are "mere advertising" versus more sufficiently meaningful in-state activity that should properly be characterized as "soliciting business" for purposes of meeting the definition of a "retailer engaged in business in this state." Given the evolving nature of online advertising, and the anonymous manner in which it may be delivered to online customers, it is important to note that, in isolation, online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites, and similar online advertising services should not be considered a "referral" under subparagraph (5)(A), nor "direct or indirect solicitation specifically targeted at potential customers in the state" under subparagraph (5)(C). Those types of advertising services are generated as a result of generic algorithmic functions and are anonymous and passive in nature and thus do not rise to the level of referring or soliciting business. Agreements for such advertising services are not covered, unless the person entering the agreement also engages in other activities on

behalf of the retailer in this state – such as sending flyers or making phone calls – that are specifically targeted at customers in this state.

The written comment from the Internet Alliance, NetChoice, AOL, Inc., Yahoo!, Inc., and Google, Inc. also recommended revising staff's recommended amendments incorporating the affiliate nexus provisions into Regulation 1684 so that the amendments conform to the statements of intent. (Exhibit 3.)

Second Discussion Paper

Board staff responded to the interested parties' comments in the Second Discussion Paper issued on December 9, 2011. Board staff generally agreed with Sutherland Asbill & Brennan LLP's suggestions to revise staff's proposed amendments adding subdivision (c)(2) to Regulation 1684 to define the phrase "in cooperation with" and clarify that subdivision (c)(2) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property. Therefore, staff recommended that new paragraph (c)(2)(B)(i) be added to Regulation 1684 to provide that "services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property." Staff also recommended that new paragraph (c)(2)(B)(ii) be added to Regulation 1684 to define "in cooperation with" in accordance with the general definition of the term, which is that "cooperation" is "an act or instance of working or acting together for a common purpose or benefit." (Dictionary.com.)

Board staff also generally agreed with Sutherland Asbill & Brennan LLP that the phrase "other consideration" should be further clarified. Therefore, Board staff revised its recommended amendments incorporating the affiliate nexus provisions into Regulation 1684 so that they further explain that the consideration referred to in section 6203, subdivision (c)(5), as added by AB 155, is any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise."

Further, Board staff generally agreed with Sutherland Asbill & Brennan LLP's comment that "the method of compensation should not convert an otherwise permissible advertisement into a market-making activity" that creates substantial nexus. Therefore, Board staff revised its recommended amendments explaining how a retailer can effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus so that the amendments do not prohibit an agreement from providing for the payment of commissions, as also suggested by Ms. Madigan.

Moreover, Board staff generally agreed with Sutherland Asbill & Brennan LLP that retailers should be excused from obtaining certificates to establish that their in-state affiliates did not perform prohibited solicitation activities in California under appropriate circumstances, including where the person required to make the certification is deceased. Therefore, Board staff revised its recommended amendments so that the amendments excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

Additionally, Board staff generally agreed with Sutherland Asbill & Brennan LLP that staff's recommended amendments to Regulation 1684 should clarify whether "a static link that is labeled 'click here' constitutes a solicitation. Board staff also agreed with the comment from Internet Alliance,

NetChoice, AOL, Inc., Yahoo!, Inc., and Google, Inc. that staff's recommended amendments to Regulation 1684 should conform to the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal. After reviewing the statements of intent in detail and interpreting the amendments made to section 6203 by AB 155 in light of the statements of intent, staff concluded that:

- The Legislature intended for the new provisions of section 6203, subdivision (c)(5)(A)-(C) "to draw a clear line between activities that are 'mere advertising' versus more sufficiently meaningful in-state activity that should properly be characterized as 'soliciting business' for purposes of meeting the definition of a 'retailer engaged in business in this state.'"

- The Legislature did not intend for section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions to apply to an agreement under which a retailer purchases online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services. In short, the Legislature has implicitly presumed that persons who enter into this type of agreement with a retailer generally do not directly or indirectly solicit potential customers for the retailer in California.

- Based on the language in subdivision (c)(5)(B) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer purchases advertisements from a person in this state to be delivered on television, radio, in print, on the Internet, or by any other medium when the advertisement revenue paid to the person *is not based* on commissions or other consideration that is based upon completed sales of tangible personal property. However, the affiliate nexus provisions of subdivision (c)(5)(A) *do apply* to such agreements when the advertisement revenue paid *is based* on commissions or other consideration that is based upon completed sales of tangible personal property.

- Based on the language in subdivision (c)(5)(C) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, if the person entering into the agreement with the retailer *does not* directly or indirectly solicit potential customers in this state through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state. However, the affiliate nexus provisions of subdivision (c)(5)(A) *do apply* to such agreements when the person directly or indirectly *does* solicit potential customers in California through such means.

In other words, staff believes the Legislature intended to create a distinction between "traditional" advertising (i.e., involving contracts for the sale of advertising space or time with no presumed solicitation) and "nexus-producing" advertising (i.e., involving commission-based contracts with presumed solicitation).

Therefore, Board staff revised its recommended amendments defining the terms "advertisement," "solicit," and "solicitation" so that the amendments provide that: (1) the term "advertisement" includes the types of online advertising specified in the statements of intent; and (2) the terms "solicit," "solicitation," "refer," and "referral" do not include the types of online advertising specified in the statements of intent. These revisions are intended to ensure that out-of-state retailers who only purchase

"advertisements" as defined in the recommended amendments will not be required to register with the Board to collect use tax as a result of such advertising.

However, Board staff did not agree with all of the interested parties comments. Board staff explained that it believes that the proper administration of the amendments made to section 6203, subdivision (c), by AB 155, requires that the Board establish a presumption that a retailer is "engaged in business in California" if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier, the United States mail, or interstate telecommunication (i.e., a presumption that a retailer is "engaged in business in California" if the retailer has any in-state physical presence). Retailers can rebut this presumption by establishing that their physical presence in California is so slight that it cannot create a substantial nexus within the meaning of the Commerce Clause. Furthermore, Board staff explained that it believes that the rebuttable presumption set forth in staff's recommended amendments adding subdivision (b)(2) to Regulation 1684 is consistent with the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*) because the presumption only applies when a retailer has a physical presence in California and the presumption that the physical presence creates a substantial nexus and corresponding use tax collection obligation can be rebutted if the retailer can show that its physical presence is so slight that it will not satisfy the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*). Therefore, staff did not revise its recommended amendments adding subdivision (b)(2) to Regulation 1684 in response to the above referenced interested parties comments.

Board staff did not agree with Sutherland Asbill & Brennan LLP's recommendation regarding defining the phrase "person or persons in this state" so that it only refers to "an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California." The term "person" is broadly defined by section 6005 and the recommended definition is inconsistent with that section. Furthermore, an individual does not need to be a resident of California and a legal entity does not need to be headquartered or domiciled in California in order to perform services in this state.

Board staff did not agree with Sutherland Asbill & Brennan LLP's recommendation to define the terms "directly," "indirectly," and "otherwise" because these are all broad terms with generally applicable meanings. However, Board staff indicated that it was open to further discussion regarding adding examples to Regulation 1684 that Sutherland Asbill & Brennan LLP believed would help clarify the meaning of these terms.

Furthermore, Board staff explained that ITFA, as renewed in 2007, imposes a moratorium on the states' imposition of two categories of taxes during the period beginning November 1, 2003, and ending November 1, 2014:

- Taxes on internet access, which means taxes imposed on a service that enable users to connect to the Internet to access content, information, or other services offered over the Internet, whether imposed on the provider or the consumer; and
- Multiple or discriminatory taxes on electronic commerce. (ITFA §§ 1101(a), 1105(5).)

ITFA provides that the term "tax" includes "the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity." (ITFA § 1105(8).) ITFA provides that "[t]he term 'multiple tax' means any tax that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other

jurisdictions." However, the term "multiple tax" does "not include a sales or use tax imposed by a State and 1 or more political subdivisions thereof on the same electronic commerce or a tax on persons engaged in electronic commerce which also may have been subject to a sales or use tax thereon." (ITFA § 1105(6)(A) & (B).) ITFA further provides that "The term 'discriminatory tax' means –

> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that – (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period; (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means; (iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or
>
> (B) any tax imposed by a State or political subdivision thereof, if – (i) the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or (ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of – (I) the display of a remote seller's information or content on the out-of-State computer server of a provider of Internet access service or online services; or (II) the processing of orders through the out-of-State computer server of a provider of Internet access service or online services. (ITFA § 1105(2).)

ITFA also provides that except as expressly provided, "nothing in this title shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act." (ITFA § 1101(b).)

Therefore, Board staff did not agree that its recommended amendments to Regulation 1684's website provisions violate ITFA. This is because the recommended amendments cannot reasonably be interpreted to impose taxes on Internet access, or multiple or discriminatory taxes within the above ITFA definitions. Board staff also concluded that the recommended amendments merely recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state. Further, Board staff concluded that the recommended amendments do not discriminate against Internet access providers or electronic commerce retailers because whatever use tax collection obligation may be imposed as a result of the amendments:

- Is generally imposed and legally collectible by California, at the same rate, on transactions involving similar property and goods accomplished through other means involving the presence of a retailer's property in this state; and
- Will not be imposed on a different person or entity than in the case of transactions involving similar property and goods accomplished through other means.

In addition, Board staff concluded that the recommended amendments will not require a retailer to collect California use tax solely because California consumers can access the retailer's "out-of-State computer server" via the Internet or deem a provider of Internet access service or online services to be the agent of a retailer for determining the retailer's use tax collection obligation solely as a result of the display of the retailer's information or content on "the out-of-State computer server of a provider of Internet access service or online services" or the processing of orders through "the out-of-State computer server of a provider of Internet access service or online services." Therefore, Board staff did not revise its recommended amendments to Regulation 1684 due to Sutherland Asbill & Brennan LLP's comments regarding ITFA.

Additional Interested Parties Meetings and Comments

Board staff conducted additional meetings with interested parties on December 20, 2011, in Sacramento, California, and December 22, 2011, in Culver City, California, to discuss the Second Discussion Paper issued December 9, 2011.

Mr. Reed Schreiter attended the December 20, 2011, meeting on behalf of PricewaterhouseCoopers LLP. Mr. Wils and Ms. Narayan attended the December 20, 2011, meeting on behalf of MuniServices, LLC, and Ms. Pielsticker attended the December 20, 2011, meeting on behalf of Sutherland Asbill & Brennan LLP. During the meeting, Ms. Pielsticker explained that she thought the use of the word "connection" in staff's recommended amendments adding subdivision (b)(2) to Regulation 1684 created some confusion as to whether the amendments were consistent with the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*) and she expressed interest in adding examples to Regulation 1684 that Sutherland Asbill & Brennan LLP believes will help clarify the meaning of the terms "directly" and "indirectly," although she did not provide specific examples during the meeting. Staff agreed to consider clarifying its recommended amendments adding subdivision (b)(2) to Regulation 1684 and to consider adding clarifying examples to its recommended amendments to Regulation 1684 if any of the interested parties had specific examples for staff to consider.

After the meeting, Sutherland Asbill & Brennan LLP submitted written comments dated January 13, 2012, regarding staff's recommended amendments to Regulation 1684. (Exhibit 4.) Sutherland Asbill & Brennan LLP's written comments recommend that Board staff:

1. Delete the rebuttable presumption from the recommended amendments adding subdivision (b)(2) to Regulation 1684 or replace the reference to "physical connection" with a reference to "physical presence" in the recommended amendments in order to make the rebuttable presumption consistent with the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*).
2. Further clarify when a person or persons are "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155, and clarify that subdivision (c)(5)(A) only applies to a retailer when there is a person who is conducting referral "activities in California" that help the retailer establish or maintain a California market.
3. Include three examples in the recommended amendments to Regulation 1684 that clarify that the in-state activities described therein will not constitute the "indirect solicitation" of California customers within the meaning of section 6203, subdivision (c)(5)(C), as added by AB 155.
4. Consider adding "unless the computer server located in California is owned or leased by the out-of-state retailer" to the end of the first sentence in Regulation 1684's current provisions

regarding webpages and Internet services providers, instead of staff's recommended amendments adding "an unrelated third party" to the same sentence.

Mr. Reed Schreiter attended the December 22, 2011, meeting on behalf of PricewaterhouseCoopers LLP. Ms. Narayan attended the meeting on behalf of MuniServices, LLC. During the December 22, 2011, meeting, staff briefly summarized and explained its recommended amendments to Regulation 1684 and noted that staff was considering clarifying its recommended amendments adding subdivision (b)(2) to Regulation 1684. After the meeting, staff received a written comment from MuniServices, LLC that expressed MuniServices, LLC's support for staff's proposed amendments to Regulation 1684. (Exhibit 5.)

Staff's Responses to Sutherland Asbill & Brennan LLP's January 13, 2012, Written Comments

Board staff agrees with Sutherland Asbill & Brennan LLP that the recommended amendments adding subdivision (b)(2) to Regulation 1684 would be more clear if the term "physical connection" was replaced with the term "physical presence" from the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*). In addition, Board staff believes that it would be helpful if subdivision (b)(2) to Regulation 1684 explained how a retailer with a "physical presence" in California can rebut the presumption that it has a "substantial nexus" with and therefore is engaged in business in California (i.e., by establishing that its physical presence in California is so slight that a finding of substantial nexus would not be constitutionally permissible). Board staff also believes that it would be helpful to add an additional subdivision (b)(3) to Regulation 1684 to further clarify that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California. Therefore, Board staff has revised its recommended amendments adding subdivision (b) to Regulation 1684, accordingly.

Board staff further agrees with Sutherland Asbill & Brennan LLP that it would be helpful if the recommended amendments to Regulation 1684 clarified when a person is "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155. In addition, Board staff also believes that it would be helpful if Regulation 1684 further clarified that subdivision (c)(3), as recommended to be added to Regulation 1684, only applies to a retailer when an individual solicits potential customers under the retailer's agreement while the individual is physically present within the boundaries of California, and that such additional clarification would help ensure that subdivision (c)(3) is interpreted and administered consistently with *Tyler Pipe* and *Borders Online*. Therefore, Board staff is now recommending adding a new subdivision (c)(5) to Regulations 1684 to further clarify when an individual is in this state within the meaning of section 6203, subdivision (c)(5)(A), and adding a new subdivision (c)(6) to Regulation 1684 to clarify when subdivision (c)(3) of Regulation 1684 applies. Board staff is also recommending adding new subdivision (c)(8)(B) and (C) to define the term "individual" as referring to a "natural person" and define the term "person" by reference to the definition in section 6005.

Additionally, Board staff agrees with Sutherland Asbill & Brennan LLP that it would be helpful to add examples to Regulation 1684 to illustrate the application of subdivision (c)(3), as recommended to be added to Regulation 1684, and provide examples of "direct and indirect" solicitation within the meaning of subdivision (c)(3). Therefore, Board staff is now recommending adding a new subdivision (c)(9) to Regulation 1684 to provide such examples. Further, Board staff generally agrees with the examples set forth in Sutherland Asbill & Brennan LLP's January 13, 2012, written comments (see Exhibit 4) so long

as the "emails" and "tweets" referenced therein do not constitute solicitations. However, Board staff believes that the operative facts from all three examples can be incorporated into two examples that illustrate the same factual scenarios because staff does not see any substantive distinction between posting an advertisement on a person's website and posting an advertisement on a person's facebook.com webpage. Board staff also believes that the combined examples should refer to the use of email, rather than "tweets," because email is more commonly used presently and the same principles apply in determining whether an email or tweet constitutes a solicitation, as opposed to an advertisement. Furthermore, Board staff believes that the examples should be revised so that they do not refer to real businesses' actual domain names, such as facebook.com., hiking.com, and itunes.com. Therefore, Board staff is now recommending that the combined examples be added to subdivision (c)(9)(A) and (B) of Regulation 1684 without the references to the actual domain names. In addition, staff believes that it would be helpful to add an additional example that does involve the requisite in-state solicitation activities, so that the example can be used to illustrate "direct and indirect" solicitation activities that can create "affiliate nexus" under subdivision (c)(3), as recommended to be added to Regulation 1684. Therefore, Board staff is now recommending to add such an example to subdivision (c)(9)(C) of Regulation 1684.

Finally, staff agrees with Sutherland Asbill & Brennan LLP's alternative amendments to the first sentence in Regulation 1684's current provisions regarding webpages and Internet service providers and staff has incorporated the alternative into its recommended amendments to Regulation 1684. Staff believes that the alternative amendments achieve staff's intended purpose, which was to amend the provisions regarding webpages and Internet service providers to "recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state," as stated in Sutherland Asbill & Brennan LLP's written comments.

A. Description of Alternative 1

Approve and authorize publication of Board staff's recommended amendments to Regulation 1684, as set forth in Exhibit 2. After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommends that Regulation 1684 be amended to:

- Incorporate the new provisions of section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;

- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise," similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor;
- Create a means by which a retailer can effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting, and conform the definitions for the terms "advertisement," "solicit," "solicitation," "refer" and "referral" to the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal;
- Define the term "person" by reference to the definition of "person" set forth in section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);

- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Board staff also recommends that the Board:

- Retain the other current provisions of Regulation 1684 regarding the "taking of orders from customers in this state through a computer telecommunications network" based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

B. Pros of Alternative 1

- Board staff's recommended amendments will ensure that Regulation 1684 is consistent with the provisions of new section 6203, when new section 6203 becomes operative.
- Board staff's recommended amendments ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Tyler Pipe*, *Scripto*, *National Geographic Society*, *Current*, and *Borders Online*.
- Board staff's recommended amendments ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently with the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal.
- Board staff's recommended amendments will also provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board, and provide more certainty to retailers regarding their new use tax collection obligations before new section 6203 becomes operative.

C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require adoption of amendments to Regulation 1684.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1684 and thereby begin the formal rulemaking process. Staff will also notify taxpayers of the amendments to Regulation 1684 through other outreach efforts.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation is considered routine. However, the costs associated with the overall implementation of AB 155 are substantive; the Board of Equalization has a pending Budget Change Proposal requesting funds related to enactment of this bill.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff believes the amendments will help taxpayers and staff understand when a retailer is considered to be engaged in business in this state and required to register and collect use tax.

H. Critical Time Frames of Alternative 1

Implementation will begin 30 days following approval of the amended regulation by the State Office of Administrative Law. The amended regulation will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amended regulation will become operative on January 1, 2013.

VII. Alternative 2

A. Description of Alternative 2

Do not amend Regulation 1684.

B. Pros of Alternative 2

The Board would avoid the workload involved with processing and publicizing the amended regulation.

C. Cons of Alternative 2

Regulation 1684 will not be entirely consistent with new section 6203, and retailers will not have any additional guidance regarding the Board's interpretation of new section 6203, when new section 6203 becomes operative.

D. Statutory or Regulatory Change for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1)

G. Taxpayer/Customer Impact of Alternative 2

Taxpayers and staff may not understand when retailers are considered engaged in business in this state and required to register and collect use tax.

H. Critical Time Frames of Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax and Fee Programs Division, Legal Department; and Tax Policy Division, Sales and Use Tax Department.

Current as of: February 9, 2012

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

BOARD OF EQUALIZATION
REVENUE ESTIMATE

Engaged in Business in this State – Obligation to Collect Use Tax

Alternative 1 – Staff Recommendation

Approve and authorize publication of Board staff's recommended amendments to Regulation 1684, as set forth in Exhibit 2. After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommends that Regulation 1684 be amended to:

- Incorporate the new provisions of section 6203, subdivision (c), as amended by AB 155 (new subdivision (c)), providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty";
- Incorporate the non-exhaustive examples of retailers with substantial nexus set forth in new subdivision (c), including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer;
- Explain that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit for purposes of the commonly controlled group nexus provisions;

- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in the affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period to be engaged in business in California under the affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf for purposes of the affiliate nexus provisions;
- Clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor;
- Create a means by which a retailer can effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus by utilizing contractual terms and factual certifications, and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" and conform the definitions for the terms "advertisement," "solicit," "solicitation," "refer" and "referral" to the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal (the statements are included in Exhibit 3);
- Define the terms "person" and "individual" for purposes of applying the affiliate nexus provisions;
- Provide three examples illustrating the application of the affiliate nexus provisions;
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments to Regulation 1684 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Board staff also recommends that the Board:

- Retain the other current provisions of Regulation 1684 regarding the "taking of orders from customers in this state through a computer telecommunications network" based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

Alternative 2 - Other Alternative Considered

Do not amend Regulation 1684.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in staff recommendation that would impact sales and use tax revenue. Staff recommended amendments will ensure that Regulation 1684 is consistent with the provisions of new section 6203, when new section 6203 becomes operative. In addition, staff recommendations will ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Tyler Pipe*, *Scripto*, *National Geographic Society*, *Current*, and *Borders Online*. Further, staff recommendations will ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently with the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal. Finally, staff recommendations will also provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board, and provide more certainty to retailers regarding their new use tax collection obligations before new section 6203 becomes operative.

Alternative 2 – Other Alternative - do not amend Regulation 1684

There is nothing in alternative 2 that would impact sales and use tax revenue.

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

Other alternatives considered – Alternative 2 does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Robert Ingenito, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of February 10, 2012.

1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances ~~this state is a "retailer engaged in business in this state" and~~the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee~~).~~;

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in

California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who

is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online

advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by ~~an out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the

retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(~~b~~3) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(~~1~~A) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(~~2~~B) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~d~~f) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~e~~g) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~f~~h) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

November 18, 2011

Via Facsimile (916) 322-4530 and First Class Mail

Susanne Buehler
Chief, Tax Policy Division
Sales and Use Tax Department
California State Board of Equalization
P.O. Box 942879
Sacramento, CA 84279-0092

Re: Proposed Amendments to Regulation 1684

Dear Ms. Buehler:

This letter is submitted on behalf of Yahoo!, AOL, Google, NetChoice and the Internet Alliance to provide comments in response to written notification by the State Board of Equalization ("BOE") issued on October 14, 2011 concerning the proposed amendments to Regulation 1684, *Collection of Use Tax by Retailers*. Specifically, we recommend revisions to the amendments to provide clarity and consistency with the legislative intent in enacting ABX128/AB155 as they relate to the Revenue and Taxation Code § 6203(C)(5)(A)-(C).

The proposed amendments to Regulation 1684(c)(5) define the terms "advertisement", "solicit" and "solicitation" for purposes of subdivision (c). As currently stated, the regulation is susceptible to an interpretation broader than that intended by the California legislature. The Assembly Daily Journal for the 2011-12 Regular Session (*see Exhibit 1*) and First Extraordinary Session (*see Exhibit 2*) (September 9, 2011) provided by unanimous consent to print in the journal a statement of legislative intent clarifying the distinction between advertising and activities which rise to the level of solicitation sufficient to meet the definition of a "retailer engaged in business in this state" under Revenue and Taxation Code § 6203.[1]

Valid regulatory provisions must comply with the state Administrative Procedures Act ("Act"). Pursuant to this Act, a regulation must be reviewed for clarity and consistency with the law by the Office of Administrative Law prior to submission to the Secretary of State.[2] A regulation which fails to meet these requirements should not be approved and may be judicially declared invalid.[3]

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[1] Please note that the facsimile transmission of these exhibits only includes the pertinent legislative intent statements, however, the entire documents have been included in the original we are sending via first class mail.

[2] Government Code §§ 11340.5, 11349, 11349.1 and 11349.3. *See also Morning Star Company v. State Board of Equalization*, 132 P.3d 249, 254 (Cal. 2006) and *Naturist Action Committee v. Department of Parks and Recreation*, 96 Cal. Rptr.3d 620, 624 (Cal. Ct. App. 2009).

[3] *Id.*

The following revisions[4] to the amendments to Regulation 1684 provide clarity and consistency with the statement of legislative intent as it relates to activities which constitute mere advertising and therefore, are not properly categorized as a referral or solicitation:

> (3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a commission or other consideration that is based upon completed sales of tangible personal property, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise, provided that: (A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and (B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).
>
> The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.
>
> <u>For purposes of this paragraph, the terms "refer" or "referral" does not include online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services.</u>
>
> For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes. However, this paragraph does not apply to an agreement under which a retailer purchases advertisements from a person in

[4] Additional language is underlined.

California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless (A) the advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property and (B) the person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

...

(5) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public;

(B) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers. The term solicit does not include online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services; and

(C) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property for a specific retailer or retailers. The term solicitation does not include online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services.

We appreciate this opportunity to comment on the proposed amendments to Regulation 1684. Please don't hesitate to contact us if you have any questions or would like additional information.

Very truly yours,

Tammy Cota, Executive Director
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Leslie Miller, Senior Manager, Public Policy
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Mountain View, CA 94043
lfmiller@google.com

Enclosure

EXHIBIT 1

CALIFORNIA LEGISLATURE

2011–12 REGULAR SESSION

ASSEMBLY DAILY JOURNAL

Friday, September 9, 2011

ONE HUNDRED TWENTY-SEVENTH SESSION DAY

TWO HUNDRED SEVENTY-EIGHTH CALENDAR DAY

AT SACRAMENTO, CALIFORNIA

NOTE: Official record of roll call votes; all amendments considered by the Assembly on this day are on file with the Chief Clerk of the Assembly and available on request. A list of all measures amended and on which amendments were offered is shown on the final page of this day's Assembly Journal.

(Please direct any inquiries and report any omissions or errors to Minute Clerk: Phone 916-319-2360)

Legislative Intent—Assembly Bill No. 155

September 9, 2011

E. Dotson Wilson
Chief Clerk of the Assembly
State Capitol, Room 3196
Sacramento, California

RE: Letter to the Journal—Assembly Bill 155

Dear Mr. Wilson: We respectfully submit this Letter to the Journal to document the legislative intent of AB 155, passed by this body in 2011.

As the authors and co-author of AB 155, we are writing to clarify our intent with regard to Revenue and Taxation Code Section 6203(c)(5)(A)–(C). These provisions were meant to draw a clear line between activities that are "mere advertising" versus more sufficiently meaningful in-state activity that should properly be characterized as "soliciting business" for purposes of meeting the definition of a "retailer engaged in business in this state." Given the evolving nature of online advertising, and the anonymous manner in which it may be delivered to online customers, it is important to note that, in isolation, online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services should not be considered a "referral" under subparagraph 5(A), nor "direct or indirect solicitation specifically targeted at potential customers in this state" under subparagraph 5(C). Those types of advertising services are generated as a result of generic algorithmic functions and are anonymous and passive in nature and thus do not rise to the level of referring or soliciting business. Agreements for such advertising services are not covered, unless the person entering the agreement also engages in other activities on behalf of the retailer in this state—such as sending flyers or making phone calls—that are specifically targeted at customers in this state.

Thank you for the opportunity to clarify this matter.

Sincerely,

CHARLES M. CALDERON, Assembly Member
Fifty-eighth District

NANCY SKINNER, Assembly Member
Fourteenth District

LONI HANCOCK, State Senator
Ninth District

EXHIBIT 2

CALIFORNIA LEGISLATURE

2011–12 FIRST EXTRAORDINARY SESSION

ASSEMBLY DAILY JOURNAL

Friday, September 9, 2011

SIXTY-FOURTH SESSION DAY

TWO HUNDRED SEVENTY-EIGHTH CALENDAR DAY

AT SACRAMENTO, CALIFORNIA

NOTE: Official record of roll call votes; all amendments considered by the Assembly on this day are on file with the Chief Clerk of the Assembly and available on request. A list of all measures amended and on which amendments were offered is shown on the final page of this day's Assembly Journal.

(Please direct any inquiries and report any omissions or errors to Minute Clerk: Phone 916-319-2360)

①

REQUEST FOR UNANIMOUS CONSENT TO PRINT IN JOURNAL

Assembly Member Charles Calderon was granted unanimous consent that the following statement of legislative intent be printed in the Journal:

Legislative Intent—Assembly Bill No. 28

September 9, 2011

E. Dotson Wilson
Chief Clerk of the Assembly
State Capitol, Room 3196
Sacramento, California

RE: Letter to the Journal—Assembly Bill X1 28
(Chapter 7, Statutes of 2011)

Dear Mr. Wilson: We respectfully submit this Letter to the Journal to document the legislative intent of my ABX1 28, passed by this body in 2011 and the original bill AB 153 upon which ABX1 28 was based.

As authors of ABX1 28 and AB 153, respectively, we are writing to clarify our intent with regard to Revenue and Taxation Code Section 6203(c)(5)(A)-(C). These provisions were meant to draw a clear line between activities that are "mere advertising" versus more sufficiently meaningful in-state activity that should properly be characterized as "soliciting business" for purposes of meeting the definition of a "retailer engaged in business in this state." Given the evolving nature of online advertising, and the anonymous manner in which it may be delivered to online customers, it is important to note that, in isolation, online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services should not be considered a "referral" under subparagraph 5(A), nor "direct or indirect solicitation specifically targeted at potential customers in this state" under subparagraph 5(C). Those types of advertising services are generated as a result of generic algorithmic functions and are anonymous and passive in nature and thus do not rise to the level of referring or soliciting business. Agreements for such advertising services are not covered, unless the person entering the agreement also engages in other activities on behalf of the retailer in this state—such as sending flyers or making phone calls—that are specifically targeted at customers in this state.

Thank you for the opportunity to clarify this matter.

Sincerely,

BOB BLUMENFIELD, Assembly Member
Fortieth District
NANCY SKINNER, Assembly Member
Fourteenth District

MESSAGES FROM THE SENATE

Senate Chamber, September 10, 2011

Mr. Speaker: I am directed to inform your honorable body that the Senate on this day adopted:

Senate Concurrent Resolution No. 2

GREGORY P. SCHMIDT, Secretary of the Senate
By Bernadette McNulty, Assistant Secretary

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ATLANTA
AUSTIN
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WASHINGTON DC

January 13, 2012

Ms. Susanne Buehler, Chief
Tax Policy Division/Sales and Use Tax
California State Board of Equalization
450 N Street
Sacramento, California 94279-0092

Re: Comments on Proposed Amendments to Regulation 1684
Collection of Use Tax by Retailers

Dear Ms. Buehler:

We write to offer comments on the Board of Equalization's ("BOE") proposed amendments to Sales and Use Tax Regulation 1684 ("Proposed Regulation") as set forth in the Second Discussion Paper, dated December 9, 2011. We appreciate BOE staff's response to our comments, dated November 18, 2011, and have provided additional comments as set forth below. We welcome the opportunity to discuss our comments with you at any time.

1. Clarify "Person or Persons in this State" As Referenced in The Affiliate Nexus (Click-Through Nexus) Provision.

AB 155 modifies the definition of "retailer engaged in business in this state" by adding 6203(c)(5) to include:

(A) Any retailer entering into an agreement or agreements under which a *person or persons in this state*, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise, provided that both of the following conditions are met:

(i) The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000).

(ii) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of five hundred thousand dollars ($500,000).

(emphasis added).

In our comments dated November 18, 2011, we suggested that "a person or persons in this state" should be defined. We further suggested that the BOE should clarify that "a person in this state" refers to an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California. We also suggested that the Proposed Regulation make clear that "a person in this state" must be limited to those in-state persons who are performing activities to establish or maintain *a California market.*

We understand that the BOE staff was not inclined to adopt our recommendations and specifically stated in its December 9, 2011 response that "*an individual does not need to be a resident of California and a legal entity does not need to be headquartered or domiciled in California in order to perform services in this state.*" As a result of the BOE's response, we request that the BOE implement two clarifications: (1) provide another objective measurement for determining whether a person is "in this state"; and (2) make clear that "a person in this state" must be referring potential California purchasers of tangible personal property to retailer. For example, with respect to the first requirement, if the residence or business address of the person that the retailer enters into an agreement with is in this state then the person would be presumed to be "in this state" as required by this provision. Without such an objective mechanism, retailers may be unable to verify whether the person performs service in this state as was noted by the BOE. In addition, with respect to the second clarification, the U.S. Supreme Court has held that in order for an agent or representative to establish nexus for an out-of-state retailer, the agent or representative must be establishing or maintaining a market *in the state.* Thus, it should be clarified that the "person in this state" must be conducting activities in California that establish or maintain a market for the retailer in California.

2. Clarify "Direct or Indirect" Solicitation As Referenced in The Affiliate Nexus (Click-Through Nexus) Provision.

AB 155 also provides certain exceptions to the new definition of "retailer engaged in business in this state" set forth in 6203(c)(5)(A) to include:

(B) An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property.

(C) Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of *direct or indirect* solicitation specifically targeted at potential customers in this state.

(D) For purposes of this paragraph, "retailer" includes an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code.

(emphasis added).

The BOE staff has indicated that it disagrees that the words "directly or indirectly" require further clarification. Thus, Sutherland requests that the BOE staff provide additional examples to illustrate when a solicitation is "indirect."

The following examples are suggested:

Example 1. Hiking.com contains links to retailers' websites that allow customers to click through to the website to purchase hiking gear and accessorics. Hiking.com receives a commission for each click-through that results in a completed sale based on an agreement with each retailer. Hiking.com posts reviews via the Internet of the various products sold via the links. Hiking.com does not solicit customers for these retailers, and therefore will not create nexus for the retailers.

Example 2. Hiking.com contains links to retailers' websites that allow customers to click through to the website to purchase hiking gear and accessories. Hiking.com receives a commission for each click-through that results in a completed sale based on an agreement with each retailer. Hiking.com posts reviews via the Internet of the various products sold via the links. In addition, Hiking.com also post advertisements and messages on Facebook and sends "tweets" via Twitter regarding the various products sold via the links. Hiking.com does not solicit customers for these retailers, and therefore will not create nexus for the retailers.

Example 3. Tunes.com allows customers to listen to music samples and offers suggestions regarding which songs customers should purchase based on the customers' stated musical preferences. Tunes.com posts a variety of click-through links to retailers' websites offering for sale music described on the Tunes.com website, and receives a commission from those retailers based on completed sales. Tunes.com does not solicit customers for these retailers; however, Tunes.com has advertising agreements with other unrelated third parties to

send emails to potential customers promoting the retailers' websites offerings. Tunes.com does not solicit customers for these retailers and therefore will not create nexus for the retailers.

3. Remove Rebuttable Presumption in Proposed Regulation 1684(b)(2)

The Proposed Regulation adds section (b)(2) which provides:

> Except as provided in subdivisions (c) and (d), there is a rebuttable presumption that a retailer is engaged in business in this state as defined in 6203 of the Revenue and Taxation Code if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier, the United States mail, or interstate telecommunication.

As stated in Sutherland's comments dated November 18, 2011, the BOE should strike language creating a rebuttable presumption that a retailer is doing business in this state "if the retailer has any physical connection to California besides a connection with customers that is exclusively by means of interstate commerce." Prop. Reg. 1684(b)(2). As stated previously, the rebuttable presumption is beyond the scope of the statute. *The statute does not contain a presumption.* Furthermore, a retailer should not be presumed to be doing business in this state when it lacks sufficient connection with this state to justify imposition of sales or use tax under the Commerce and Due Process Clauses of the United States Constitution. In cases where a sufficient connection is not evident, the burden should rest with California to show it has jurisdiction to impose a sales and use tax rather than with the taxpayer to disprove jurisdiction.

In addition, Sutherland maintains that "any physical connection to California" is insufficient to satisfy the Commerce Clause's substantial nexus standard under *Nat'l Geographic Society v. Calif. Bd. of Equalization,* 430 U.S. 551, 556 (1977). However, even if Subsection (b)(2) met this standard, the term "physical connection" requires further clarification. For example, use of a third party contractor to perform warranty and repair work arguably creates a physical connection to California and is not a connection that is "exclusively by means of interstate commerce," but the Board has determined that this level of connection is insufficient to create substantial nexus for the out-of-state retailer engaging the third party contractor. The term "physical connection" should be changed to "physical presence" to be consistent with the *Quill* physical presence standard. The use of the term "physical presence" rather than "physical connection" is consistent with BOE staff's First and Second Discussion Papers, which reaffirm "[i]n the absence of congressional action, the bright-line rule established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 386 U.S. 753 (1967), that a retailer must have a 'physical presence' in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today." (citations omitted) First Discussion Paper at 4; Second Discussion Paper at 4.

4. Revise Amendments to Proposed Regulation 1684(d)(1)– Web Pages and Internet Service Providers

The Proposed Regulation modifies the "Web Pages and Internet Service Providers" exception set forth in (d)(1) to indicate that only use of an "unrelated third party's" computer server on the Internet is excepted. In its November 18, 2011 letter, Sutherland indicated that the BOE's proposed revision would attempt to limit California's existing computer server exemption set forth in the Proposed Regulation to use of an unrelated third party server and that such a change would be in violation of the federal Internet Tax Freedom Act ("ITFA").

In response to Sutherland's November 18, 2011 comments regarding the Proposed Regulation, BOE staff indicated: "the recommended amendments merely recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state." Second Discussion Paper at 26. Given the BOE staff's stated intent, we recommend the following amendments to Subsection (d)(1):

(1) Web Pages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California, unless the computer server located in California is owned or leased by the out-of-state retailer. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

We appreciate your consideration of our comments.

Sincerely,

Michele Pielsticker

Issue Paper 12-003
Submission from MuniServices, LLC

MuniServices, LLC.
1400 K Street, Suite 212 Sacramento, California 95814
Phone: 800.800.8181 Fax: 916.441.4688
www.MuniServices.com

January 13, 2012

Ms. Susanne Buehler, Chief
Tax Policy Division
Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0092

Re: Interested party comments: Proposed State Board of Equalization Regulation 1684, *Collection of Use Tax by Retailers*

Dear Ms. Buehler:

MuniServices received and reviewed the Second Discussion Paper for proposed Regulation 1684 to implement the provisions of AB 155 (Chapter 313, Statues of 2011). AB 155 expands the definition of "retailer engaged in business in this state." We continue to be pleased with the direction of the proposed regulation.

As previously discussed, MuniServices has been a partner of local government for over 30 years and has always encouraged and supported efforts to enforce the law for the collection and remittance of use taxes. MuniServices supported AB 155; this year we will support H.R. 3179 (co-authored by California Congresswoman Jackie Speier), the Marketplace Equity Act of 2011. As currently drafted the bill would level the playing field between out-of-state online retailers and in-state brick-and-mortar stores by providing a framework for states to require that out-of-state sellers collect and report the taxes due on their retail sales. H.R. 3179 would have less impact on current sales tax law and could be implemented sooner and without any negative impact to current sales tax law.

We look forward to working with Board Staff on the shaping of Regulation 1684, and the subsequent collection of use taxes. The estimates of unpaid taxes at approximately $1.1 billion annually, with approximately $200 million from online purchases are much needed revenues for the State and local governments to provide basic services.

Sincerely,

Brenda Narayan

Brenda Narayan
Director of Government Relations

REGULATION HISTORY

TYPE OF REGULATION: Sales and Use Tax
REGULATION: 1684
TITLE: *Collection of Use Tax by Retailers*
PREPARATION: Robert Wilke
LEGAL CONTACT: Bradley Heller/Robert Tucker

The proposed regulatory amendments implement Revenue and Taxation Code section 6203, as amended by Assembly Bill No. 155 (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013.

HISTORY OF AMENDMENTS:

February 28, 2012: Business Taxes Committee (BTC) Meeting
December 22, 2011: 2nd Interested Parties Meeting (Culver City)
December 20, 2011: 2nd Interested Parties Meeting (Sacramento
November 2, 2011: 1st Interested Parties Meeting (Culver City)
October 31, 2011: 1st Interested Parties Meeting (Sacramento)
September 15, 2011: Topic Placed on BTC Calendar

Sponsor: Board Staff

Support: None

Oppose: None

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

FEBRUARY 28, 2012

BUSINESS TAXES COMMITTEE

Reported by: Juli Price Jackson

No. CSR 5214

Electronically signed by Juli Jackson (001-065-206-4972)

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2 P R E S E N T

3

4 For the Board of Equalization: Betty T. Yee
Chair

5

Michelle Steel
6 Member

7 Jerome Horton
Member

8

9 Marcy Jo Mandel
Appearing for John
10 Chiang, State
Controller
11 (per Government Code
Section 7.9)

12

Diane G. Olson
13 Chief, Board
Proceedings Division

14

15

16 ---oOo---

17 For Staff: Susanne Buehler
Chief
18 Tax Policy Division
Sales and Use Tax
19 Department

20 Bradley Heller
Tax Counsel IV
21 Tax and Fee Division
Legal Department

22 ---oOo---

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1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 FEBRUARY 28, 2012
4 ---oOo---
5 MR. HORTON: Ms. Olson, what is our next item?
6 MS. OLSON: Our next item on today's agenda is
7 the Business Taxes Committee. Ms. Yee is the Chair of
8 that committee.
9 Ms. Yee.
10 MS. YEE: Thank you very much. --
11 Okay, let me have staff come up on this item.
12 We have one issue before the Business Taxes
13 Committee today and that's proposed amendments to
14 Regulation 1684, collection of use tax by retailers.
15 And I'll ask Ms. Buehler and Mr. Heller to
16 introduce this issue.
17 Good morning.
18 MS. BUEHLER: Good morning. I am Susanne
19 Buehler with the Sales and Use Tax Department. With me
20 today is Bradley Heller from our Legal Department.
21 We have one agenda item for the Committee this
22 morning. Staff requests your approval and authorization
23 to publish our proposed amendments to Regulation 1684,
24 collection of use tax by retailers.
25 Proposed amendments implement, interpret and
26 make specific the amendments made to Revenue and
27 Taxation Code Section 6203, by Section 3 of Assembly
28 Bill 155, which will change the definition of "retailer

1 engaged in business in this state," operative
2 September 15th, 2012 or January 1st, 2013.
3 At this point I will turn it to Mr. Heller, who
4 will provide additional information, after which we'd be
5 happy to answer any questions you may have.
6 MS. YEE: All right, thank you. Good morning.
7 MR. HELLER: Good morning, Members of the
8 Board. Again, I'm Bradley Heller with the Board's Legal
9 Department.
10 And I just wanted to mention that AB 155 made
11 California a substantial nexus state and set forth
12 several examples of how -- or I should say two specific
13 examples of how an out-of-state retailer may establish a
14 substantial nexus with California when a member of the
15 retailer's commonly controlled group performs services
16 in California, or the retailer's affiliate performs
17 services in California for the retailer.
18 Therefore, Board staff analyzed AB 155, the
19 legislature's statement of intent regarding AB 155, both
20 federal and State case law regarding substantial nexus,
21 and all of the interested parties' comments.
22 And Board staff is recommending amendments to
23 Regulation 1684 that staff thinks -- or staff believes
24 are necessary to give out-of-state retailers notice that
25 California is now a substantial nexus state, clarify the
26 types of in-state services that can give rise to
27 controlled group nexus under AB 155 and that -- and
28 clarify that they are services that help a retailer

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1 establish and/or maintain a California market because
2 those are the types of services the US Supreme Court has
3 previously concluded create a substantial nexus for a
4 retailer in a taxing state.
5 And also we want -- and also have recommended
6 clarifying that an out-of-state retailer will establish
7 affiliate nexus with California under AB 155 if the
8 retailer enters into an agreement under which a person
9 or persons in the state actually solicit California
10 customers and that the legislature did not intend for
11 out-of-state retailers to establish affiliate nexus
12 solely because they purchased anonymous and passive
13 online advertising, as opposed to engaging in more
14 meaningful in-state activity that can be properly
15 characterized as solicitation.
16 Board staff's recommendations are based upon
17 the best available factual information at this time and
18 all of our understanding of available resources.
19 And, again, we're both available to answer any
20 questions you may have and we're recommending that the
21 Board adopt -- or publish the proposed amendments --
22 recommended amendments, excuse me.
23 MS. YEE: Thank you, Mr. Heller.
24 Discussion, Members?
25 MR. RUNNER: I just have questions here --
26 MS. YEE: Ms. Steel.
27 MS. STEEL: -- that presumption, the -- it's
28 very tough to have the presumption requires for any

1 retailer's prove it.
2 So, can you explain little more about that
3 presumptions? That's my first question.
4 And second question is Board didn't approve
5 here and who's liable? I guess it's the store owners.
6 And third, that one time certification that --
7 you know, that they have to certified every year that
8 they have to apply it, that -- you know, how many staff
9 is going to work on it and how much it's going to cost
10 instead of doing that only one time certification and
11 then when there is any change they can report us back.
12 I think that's much better way to do it.
13 So, can you just answer those three questions?
14 MR. HELLER: Sure. Ms. Steel, could you
15 restate the middle question? I don't think I totally
16 understood what you were asking.
17 MR. RUNNER: Let's from the first go
18 presumptions part.
19 MR. HELLER: Okay, about how it applies to a --
20 MS. STEEL: Right, right.
21 MR. HELLER: -- specific retailer?
22 MR. RUNNER: Right, right.
23 MR. HELLER: Perfect, okay. Thank you.
24 Essentially, as I indicated before, AB 155
25 makes California a substantial nexus state, which --
26 which means that if a retailer has a substantial nexus
27 with California, the retailer's required to register to
28 collect California use tax.

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1 Federal -- federal case law, particularly US
2 Supreme Court cases, have established what they call a
3 physical presence test for establishing whether -- or
4 determining whether an out-of-state retailer has a
5 substantial nexus.
6 And under that test, basically, if a retailer
7 has a physical presence in the taxing state and that
8 physical presence is -- is not considered so slight that
9 it cannot support a use tax collection obligation, then
10 that physical presence alone is sufficient for the State
11 to impose a use tax collection obligation.
12 The Supreme Court has not clearly defined what
13 is "the slightest physical presence." We have a few
14 cases out there with examples.
15 MS. STEEL: So, we are waiting for that ruling
16 or --
17 MR. HELLER: We are not waiting for that at
18 this point. I don't believe the Supreme Court has any
19 cases on its docket or any that I'm expecting to get
20 there any time soon that would further clarify what is
21 the slightest presence.
22 And it's essentially a facts and circumstances
23 test where you have to look at the physical presence
24 and, essentially, compare the circumstances with the
25 ones that the Court has ruled on before and determine
26 whether or not we feel that they're so slight that it
27 wouldn't be reasonable or would be too burdensome to
28 impose a use tax collection obligation for -- on a

1 retailer who just -- who had those minimal contacts.
2 And, so, in this case, the reason staff's
3 recommending a presumption is really to let retailers
4 know that if they have a physical presence in
5 California, then essentially, under federal Supreme
6 Court cases, they are required to register -- they have
7 a substantial nexus with California and they're required
8 to register to collect California use tax unless their
9 presence is so slight, under the limited guidance we
10 have, that they can -- that they -- that, basically,
11 that California's prohibited under the federal
12 constitution from requiring them to register.
13 And in that case, we've created the presumption
14 to make sure that retailers understood that really if
15 they do have a physical presence and staff knows they
16 have a physical presence, staff's going to expect them
17 to provide information to establish that they are --
18 that their presence is so slight that it can't support a
19 use tax obligation.
20 Otherwise, I think it's -- we'll proceed to
21 assume that that physical presence creates a substantial
22 nexus and we wanted create this presumption so that
23 retailers don't think that they can just have a little
24 contact here and a little physical presence there and
25 then ignore our notices when we contact them and have no
26 preparation in advance for explaining how -- how the
27 Supreme Court's interpretation of the interstate
28 commerce clause protects them.

1 And, so, it's really our hundred percent
2 intention of just providing real advance notice to those
3 out-of-state retailers. And, in addition, the way that
4 it's worded is it's a completely rebuttable presumption.
5 It doesn't apply until a retailer actually has a
6 physical presence in California.
7 And then we also tried to add language
8 consistent with other Supreme Court cases that clarifies
9 that you -- that there is no physical presence as long
10 as a retailer maintains all of their contacts through
11 interstate telecommunications and interstate --
12 interstate deliveries through common carriers.
13 MR. RUNNER: But how we going to differentiate
14 slight presentation? I mean, how -- the presumption
15 gives all the stores, whenever they use for the
16 internet, just like, you know, using somebody else's
17 company and that's presentation to so slight
18 presentation, how you going to -- how we going to figure
19 it out that, you know, what's slight presentations?
20 I really cannot understand that we are not
21 really giving them -- it's not I cannot understand --
22 it's we are not really giving them right guidelines
23 right there.
24 "Slight presentation" what is -- exactly what
25 slight presentations?
26 MR. HELLER: Ms. Steel, I absolutely appreciate
27 your concern and if I had a lot more guidance and there
28 was more -- if the US Supreme Court had explained

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1 exactly what the bright line of "slight is to
2 substantial" actually is, then staff would be
3 recommending incorporating it into the regulation and
4 providing that guidance to retailers.
5 And, honestly, staff's in the same position you
6 are. We would like to have that guidance from some
7 court if we -- if it was available, but right now the
8 Supreme Court has just ruled on a few cases. They've
9 said in a few circumstances when something was too
10 slight, but they really have not ruled. And they've
11 also indicated in a few cases when something was more
12 than too -- or more than the slightest.
13 But they've really never had any kind of bright
14 line rule and it appears to be a completely facts and
15 circumstances test that's applied as long as there is
16 some actual person or property physically located in the
17 state and it's a -- kind of a cumulative test.
18 So, that's the main reason why we really felt
19 rather than printing a bright line test, which we can't
20 do at this time, we really wanted to warn retailers that
21 they need to speak with their tax counsels and be
22 comfortable in their own -- in their own understanding
23 of constitutional case law regarding interstate commerce
24 that they don't have substantial nexus. So that if we
25 do see it with the physical presence and we contact
26 them, they can quickly explain to us why they don't --
27 aren't required to register.
28 And that's really the whole basis for that

1 presumption. And, again, we think it's completely
2 consistent with all of the -- the supreme Court's
3 interpretations of the interstate commerce clause.
4 MS. STEEL: It seems like presumption itself is
5 that all the retailers are responsible, no matter that
6 they use, how slight it is because if you don't know the
7 guidelines here -- and we don't know the guidelines --
8 how tax counsels know that they going to advise their
9 own taxpayers that -- you know, how to report that?
10 So, you know, that presumption really hurts --
11 I mean, you know, for this language comes in with a
12 presumption really bothers me.
13 Second thing is for the one time certification,
14 instead of that that we have to ask them to do every
15 year that -- how many people -- how many affiliations
16 out there that they have to do that? And then how many
17 people has to be on full-time to check all these that,
18 you know, they really did and they really applied
19 another certification annually or not?
20 I mean, why don't we change to one time
21 certification and there is any change, then they can
22 report to us, so, you knows we can change the status.
23 Why we printing that that annual certification required?
24 MR. HELLER: Thank you for the question,
25 Ms. Steel.
26 Essentially -- well, first of all, let me just
27 you some background on the origin of the provision and
28 then I can kind of, I think, hopefully answer the

1 questions about why we're recommending it and give you
2 some input on how or why we might want to change it if
3 the Board sees things differently than what staff's
4 recommending.
5 First off, New York has implemented an
6 affiliate nexus statute and their Department of Finance
7 and Revenue has adopted provisions for retailers to
8 establish that their agreements are not the types of
9 agreements that create affiliate nexus in New York.
10 And these provisions are substantially based on
11 those. And the New York provisions also have the same
12 annual certification requirement.
13 So, first and foremost, we were looking to
14 New York as a kind of a template. And then seeing if
15 their provisions were -- seemed reasonable to us in
16 California. We have made a couple of modifications to
17 take out one of the requirements that New York imposed,
18 which was a requirement that the agreement not allow for
19 the payment of a commission or similar types of
20 compensation to the affiliate. We've deleted that since
21 that doesn't seem to be a critical element for creating
22 affiliate nexus, although it's -- it's one element that
23 could be looked at in whole fact pattern.
24 In this case, though, we kept the annual
25 certification requirement, essentially because we really
26 agreed with New York that we didn't want to encourage
27 retailers to just obtain one certification, say at the
28 very beginning of a contract, and then, say, go off and

1 then ignore the affiliate's activities indefinitely, say
2 -- I mean it could be forever, hundreds of years even,
3 theoretically if we don't have any requirement that they
4 ever have to check in with that retailer again.
5 And there's really nothing under those
6 circumstances to prevent a retailer from just accepting
7 that one certification, ignoring the fact that their --
8 that the affiliate may be doing any number of things
9 and, essentially, never being required to check on them
10 again and being able to disclaim all knowledge of
11 whatever solicitation activities that -- that affiliate
12 might be conducting way in the future, even, say, five
13 or six years in the future.
14 With that said, though, it's -- we're not
15 suggesting that this is the only way to address
16 affiliates. And this provision itself is really -- is
17 not a requirement in the sense that we're imposing a
18 requirement that every person who enters into a contract
19 with someone they think is an affiliate include this
20 provision or they will have nexus.
21 This provision is just an example of a way
22 where retailers can change -- can incorporate provisions
23 into their agreement to -- to show that their agreement
24 is not one of these types of agreements that -- that's
25 for solicitation activity.
26 And, so, if the Board's more comfortable with
27 an annual -- or an initial certification, I think staff
28 could -- we've talked about that idea a little bit and

1 we think it's administerable.
2 We would probably prefer, though, that we
3 change what the certification says, to some degree, and
4 then add some language to the effect that they're
5 certifying, you know, that they have not solicited under
6 the agreement and they will not solicit under the
7 agreement and that they will notify the retailer if they
8 do solicit under the agreement at any time.
9 And then I think under those circumstances then
10 the retailer doesn't need to keep checking up on them.
11 If the -- they would need to go ahead and notify the
12 retailer if they're going to be soliciting, but at
13 least -- in our mind it creates some mechanism so that
14 it's not just an autopilot certification that goes in a
15 file and is being relied on 20 years later with no
16 understanding of the factual circumstances.
17 But, again, it was, you know, our best -- our
18 best effort to try to show retailers how they can set up
19 their agreements in a way that makes it expressly state
20 that this is not a solicitation-type agreement that's
21 designed to create that type of -- or hire a person to
22 solicit in California under the circumstances that would
23 create affiliate nexus.
24 So --
25 MS. STEEL: So, how about the cost for staff --
26 staffing and annual certification requirement?
27 MR. HELLER: Well, I'll add again --
28 MS. STEEL: How many --

1 MR. HELLER: The retailers themselves, if they
2 choose to go this way, will -- well, their own -- their
3 own costs would depend on how many times that they put
4 this statement in their agreements.
5 And if they have put this in a thousand
6 agreements with a thousand affiliates and the annual
7 requirement's in there, then -- and they want to enforce
8 that with their affiliates, then they're going to be
9 required -- the retailer themselves -- to go ahead and
10 get those certifications.
11 There's really nothing at all that Board staff
12 would be involved in at that stage. And the retailer
13 would just be maintaining those certificates in case the
14 Board was to start an investigation into whether or
15 not -- or even inquire, I should say, as opposed to
16 investigate -- just inquire into whether that retailer
17 had contacts with California and then the retailer would
18 have the certificates available to substantiate whatever
19 agreements it did have with affiliates in California
20 don't create affiliate nexus.
21 MS. STEEL: So, what you are saying is we don't
22 need the extra starving for that?
23 And second thing is you -- every time they do
24 renew their certification annually, then you just put
25 that one into the file and then you're not even going to
26 look at it until the investigation started?
27 So, that and one time certification, I mean,
28 it's almost same thing here. Seems like you just put

1 those, you know, in the file and you're not going to
2 even look at it. And we don't need extra staffing.
3 And then plus on -- you know, when the investigation
4 started, then you need those that they really did every
5 year, annually or not.
6 I don't see the difference between that, you
7 know, you do a one time certification or annual
8 certification there. Seems like just more work for the
9 taxpayers at this time that they have to apply it every
10 year.
11 Well, my comment is done. Thank you.
12 MS. YEE: Thank you, Ms. Steel.
13 Other discussion, Members?
14 MS. MANDEL: Sorry, just breathing.
15 MS. YEE: Okay. I wanted to pose a couple of
16 questions.
17 First I wanted to thank staff for working
18 through these regulatory amendments. I think this is a
19 topic that is fluid, at best. And certainly trying to
20 corral all of the existing authorities to try to fashion
21 a regulation to compliment AB 155 had its set of
22 challenges.
23 My concern that I want to address really
24 relates to the issue of online advertising. And I just
25 wanted to get a sense of how we're viewing some of these
26 authorities that you relied upon.
27 The current draft includes language that I
28 believe had been provided by some of the online

1 advertisers and these are the ones who are doing
2 advertising that is the result of algorithmic functions
3 that are anonymous and passive in nature, as you
4 referred to earlier in your introduction.
5 And I was just curious as to kind of where --
6 what authority you relied on for that? I know during
7 the first interested parties' meeting there was some
8 thought that this concept of referral that was included
9 in the bill may have possibly extended to online
10 advertising and so there was kind of a different view
11 about how to look at some of these entities that were
12 doing more of this passive and anonymous-type of
13 advertising.
14 But could you just comment on kind of how you
15 ended up with that particular provision of the reg it
16 its current form?
17 MR. HELLER: Absolutely, Ms. Yee. And thank
18 you for the question.
19 First off, staff was -- let me -- let me go
20 back. The statute itself in the affiliate nexus
21 provisions basically uses three different terms. It
22 uses the term "refer." It also uses the -- refers to it
23 as "a referral" -- refer or referral and then also
24 "solicit" and then advertising -- and/or advertisements.
25 And, essentially, we -- it's clear from the
26 statute that advertisements are not intended to be
27 nexus-creating activities and that soliciting clearly is
28 intended to be a nexus-creating activity, as it was even

1 before AB 155 was enacted. And that staff was confused
2 whether -- what refer and referral exactly meant as to
3 mean where it laid in between advertising and soliciting
4 and how to look at a specific, let's say, online
5 activities as one or the other.
6 And, essentially, the statements of intent from
7 the authors of AB 155 and ABX 128 were provided to the
8 Board staff and indicated that -- at least -- or I
9 should say, shed a whole lot of light on the
10 legislature's intent with regard to where they, at
11 least, thought the line needed to be drawn as far as
12 determining when something online crosses from being
13 advertising to soliciting.
14 And I think we used this to kind of inform our
15 understanding of what the legislature meant by "refer"
16 and "referral." And when we -- when we look at the
17 statements of legislative intent, it seemed apparent
18 that the legislature was -- was not trying to create a
19 new, expanded definition of solicitation and that they
20 were really trying to direct the Board to -- to find
21 substantial nexus when, in fact, somebody's doing
22 something that's traditionally considered soliciting,
23 but via the internet or any other.
24 And, so -- and they weren't trying to say --
25 start a slippery slope that converts what used to be
26 considered advertising before AB 155 into a soliciting
27 activity if it really didn't meet the traditional
28 definition of -- adver -- or soliciting beforehand.

1 We also understood from the legislature that in
2 their minds that they had considered general forms of
3 online advertising, including, I think it was, ads
4 generated by internet search engines, banner ads,
5 click-through ads, cost per action ads and links to
6 retailers' websites. And they concluded that those were
7 generally anonymous and passive in nature and they felt
8 that when an advertisement's anonymous and passive in
9 nature, it really does fall in what they intended as an
10 advertisement and it's not traditionally considered a
11 solicitation and they didn't intend for the Board, in
12 interpreting refer and referral, to kind of bring that
13 kind of advertising activity into the definition of
14 soliciting or treat it as creating substantial nexus.
15 With that, we also received comments
16 recommending language be included in the proposed amend
17 -- or the recommended amendments. And staff considered
18 that language very carefully and did not incorporate it
19 verbatim. We tried to consider the comments as well as
20 the statements of intent from the legislature.
21 And, essentially, as opposed to incorporating
22 language that just simply said, "The terms refer or
23 referral do not include online advertising," we added
24 language indicating that they do not include online
25 advertising generated as a result of algorithmic
26 functions that is anonymous and passive in nature, such
27 as the ones identified by the legislature, the ads tied
28 to internet search engines, banner ads, et cetera.

1 And, so, that's really the process that we went
2 through in making our recommendations with regard to
3 those definitions and how we looked at the legislature's
4 intent in formulating our recommendation.
5 MS. YEE: Okay. I appreciate that.
6 A couple of concerns I have about that and that
7 is, 1, as I alluded to earlier, technology is changing
8 so rapidly and I wanted to insure the flexibility of
9 this Board to be able to reflect any changes that could
10 happen in the advertising marketplace or in technology
11 that -- such that that these generic algorithmic
12 functions, in fact, aren't anonymous or passive in
13 nature, you know, going forward. And, so, should that
14 happen, the Board would have no flexibility but to
15 reopen the reg and to amend it to try to reflect what
16 the new reality is.
17 Is that correct?
18 MS. MANDEL: Well --
19 MR. HELLER: Well, at this point, I mean, we'd
20 first be -- have to look at whether or not the regu --
21 whether or not the regulatory language applied once we
22 understood what the additional facts were.
23 And then it's possible it could be limiting.
24 We might need to reopen it to clarify what kinds of
25 online advertising meet the -- what's the intended idea
26 of the -- kind of the anonymous, passive advertising as
27 opposed to what type of online activities that appear to
28 be advertising are really, in fact, soliciting.

1 And, so, I would just to have to know what all
2 the facts are before I would say for sure whether or not
3 we'd have to reopen the regulation or if the Board could
4 just conclude that this language doesn't apply to a
5 specific activity.
6 MS. YEE: Okay, I can appreciate that.
7 What if the functions were actually controlled
8 or manipulated a salesperson?
9 MR. HELLER: Well, I think that would be a
10 major difference, at least in our understanding, that
11 really -- assuming it was designed where it's -- there
12 is an individual controlling it, it probably wouldn't be
13 passive in nature.
14 MS. YEE: Uh-huh.
15 MR. HELLER: And I don't think that this
16 definition would apply if it's really a person who's out
17 there, like a salesperson targeting specific
18 communications at customers in our state.
19 MS. YEE: Okay. My other concern really
20 relates to the authority. The authority was a letter to
21 the Journal -- and Mr. Horton, I think, can appreciate
22 this -- it was not actual legislative intent stated in
23 the legislation's itself and it was a last minute
24 clarification by the authors of the bill. So, I don't
25 consider that to be adopted, at least on the substantive
26 policy by the legislature.
27 And, so, I -- I really many resistant to having
28 that be part of the record as the underlying authority

1 for this. And I just want to know that this Board has,
2 you know, the maximum flexibility to re-visit this issue
3 should there be, as I said, changes in technology or in
4 the advertising market.
5 So, I -- I just have a real problem with
6 including that as a part of the record for rulemaking,
7 the letters to the Journal.
8 MS. MANDEL: I don't think it's the first time
9 that the Board's looked at that type of material.
10 MS. YEE: It may not be, but I also understand,
11 having monitored this bill and the timing of this
12 letter, it was on the last day of the session, it was a
13 contentious bill.
14 And I think, frankly, if this was what they
15 meant and thought they could get the votes for this
16 bill, it would be in the bill. And it wasn't.
17 So, I -- I'm concerned about that and just what
18 it means in terms of our flexibility as a Board to, you
19 know, re-visit these issues going forward.
20 Mr. Horton?
21 MR. HORTON: Yeah, I would share those concerns
22 and particularly if this issue is ever litigated. We
23 often move forward in anticipation of looking at the
24 legislation, regulation and so forth, neither of which
25 is clarified until it's litigated.
26 In that environment, if that's -- if the basis
27 of that is the intent and subsequent intent, subsequent
28 to the -- the deliberation of the bill, it's going to

1 have very little weight in the process.
2 And -- but I'm also cognizant of the fact that
3 in the regulatory process, I believe, you know, that the
4 Board has the authority to -- and should exercise that
5 authority at whatever point that we deem necessary to
6 modify the legislation -- I mean the regulation based on
7 current -- current activities.
8 And, so, in regards to Ms. Yee's question, I
9 think that at any point in time in which we think that
10 the Board is of the opinion that the legislation is no
11 longer relevant, based on just the evolution in the
12 industry, we should make those adjustments, even if that
13 happens to be relatively soon, as we begin to sort of
14 implement this.
15 And Ms. Steel's concern, I believe, has merit
16 too, to the extent of trying to just see what the actual
17 implications are relative to practice, even though it
18 may not cost us something and even though I don't
19 anticipate the taxpayer really having an onerous
20 responsibility relative to the annual certification. In
21 fact, I see it as a check and balance and will actually
22 benefit them. Because the unfortunate part is that a
23 subsequent investigation, whether they have this or
24 don't have it, is not going to relieve them of the
25 liability, if, in fact, they of not complied with the
26 law as it exists. So, it's good to have a check and
27 balance in place.
28 So, you know, but, you know, this is -- this

1 is -- this is a work in progress.
2 MS. YEE: I mean I'm prepared to, obviously,
3 support the amendments, but I'm -- I'm just really --
4 having monitored what happened on the legislation, I'm
5 really loathe to think that letters to the Journal are
6 going to be --
7 MR. HORTON: Yeah.
8 MS. YEE: -- cited as authority.
9 MR. HORTON: Well, maybe -- we're actually
10 citing that as authority?
11 Mr. Heller?
12 MR. HELLER: Mr. Horton, we're not citing it as
13 authority, we are explaining, though, at least in
14 staff's view, that staff did interpret the statute in
15 light of that statement of intent.
16 And I think if the Board was to authorize
17 publication of the recommended amendments today, staff
18 could clarify that -- that the statement of intent isn't
19 a part of a binding statute, that the Board's looking at
20 it as just a -- you know, as just what it is, it's the
21 author's comments about their intent. And that it's --
22 the Board's still free to re-visit the issue and, you
23 know, determine whether -- basically is it bound by that
24 statement of intent like it was a statute and certainly
25 can -- has the authority to determine whether or not any
26 activity is soliciting or referring or referrals and can
27 re-present the regulation itself if there's new facts.
28 MS. YEE: Yeah, I mean, I --

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1 MS. MANDEL: Go ahead.
2 MS. YEE: -- I think it's hard -- it's
3 difficult not to acknowledge the letters. Obviously,
4 the authors, you know, did want to make this
5 clarification.
6 I just don't want us to utilize the letter or
7 their stated intent as support or, you know, just
8 authority one way or the other with respect to what
9 we're doing with this regulation.
10 It's out there. It really has no force of law.
11 But I also -- but even refrain from citing it as support
12 for what we're doing in this regulation.
13 And I -- and I think that really then maintains
14 the maximum flexibility for this Board.
15 MR. HORTON: Yeah. Member Yee?
16 MS. YEE: Yes, Mr. Horton?
17 MR. HORTON: Maybe some cumulative language --
18 preponderance of the evidence -- not evidence, but the
19 intent. So, we're incorporating our thought process to
20 indicate that we're looking at the statute and we're
21 interpreting the statute.
22 And we're looking at all of the variables that
23 went into the legislature in determining those factors.
24 So, in its totality that information has informed us and
25 led us to this conclusion.
26 And I'm sure that there's -- for the linguistic
27 people out there, there are one or two words to
28 accomplish that.

1 MS. YEE: Yeah, I mean I -- if -- short of
2 withdrawing these letters as part of the record of
3 rulemaking, I would say we not cite them specifically --
4 MR. HORTON: Yes.
5 MS. YEE: -- as authority or support or
6 anything.
7 We can certainly acknowledge them as part of
8 the record, but I just want it to be neutral. So, that
9 we have the ability to re-visit this.
10 MR. HORTON: Okay.
11 MS. MANDEL: So --
12 MS. YEE: Ms. Mandel.
13 MS. MANDEL: -- but it's my understanding from
14 the definition of "advertisement" that -- that the
15 better advertisers get at slicing and dicing the online
16 community so that they can put up more targeted -- so
17 that their advertising's more targeted, you know, just
18 like it might be depending on what magazines they might
19 advertise in, but that they -- they may be reaching
20 eyeballs that might be more or less interested, that --
21 that that sort of targeted advertising is still
22 advertising because it's -- it's anonymous.
23 I mean, it's not like they're sending an e-mail
24 to my e-mail address. Is that -- as opposed to
25 solicitation, just figuring out how to target the -- the
26 audience of the banner ads is -- is still an
27 advertisement.
28 MR. HELLER: Ms. Yee, though -- or excuse me,

1 pardon me, Ms. Mandel, sorry.
2 MS. MANDEL: We both have dark hair, it's okay.
3 MR. HELLER: Ms. Mandel, pardon me, that's --
4 that's really staff's understanding of like the current
5 state of advertising online right now. And I think
6 that's consistent with what the legislature's
7 understanding is too, at least the authors' state, based
8 on their statements of intent.
9 And we think that generally banner ad and
10 click-through ads, while they still may be -- they're
11 still optimizing their placement, say, so that they're
12 trying to get in front of, you know, a group that's more
13 likely to be interested in clicking on the ad to see
14 products for sale, there -- we don't think that they're
15 at the level now that there's -- that they're being
16 targeted in the same way that somebody who's calling a
17 list of phone numbers of California residents to ask
18 them to buy specific products are targeted
19 solicitations.
20 And we don't think they are in the same way
21 that somebody who's like a paid -- a salesman sending
22 e-mails directly to California customers, trying to
23 solicit sales.
24 And, so, at this point we think that's
25 exactly -- your understanding's exactly how the
26 treatment of -- of online advertising is right now. And
27 if it doesn't change at all, it would stay that way, but
28 if it slowly becomes something that really does look

1 like the equivalent of targeting a customer and sending
2 them an e-mail, soliciting them for a particular cus --
3 retailer or calling them and soliciting them for a
4 particular retailer or going to their front door and
5 knocking and asking them to purchase something, then
6 that's the kind of activity that we think is soliciting.
7 We think the legislature agreed that's soliciting.
8 And we'll keep our eyes open if that's what --
9 that replaces what -- what is currently online
10 advertising in the future. But right now we don't know
11 that that's happening or see it happening in any way.
12 MS. YEE: Okay. I think it's not -- it's
13 conceivable that it could happen. I think it's more
14 likely to happen than not, but that's -- it's my own
15 sense.
16 Ms. Mandel.
17 MS. MANDEL: I am not going to say anything
18 else.
19 MS. YEE: Okay, all right.
20 All right, Members, any other discussion?
21 MR. HORTON: No.
22 MS. YEE: Okay. Hearing none, is there a
23 motion?
24 MR. HORTON: Move to authorize publishing the
25 proposal given the discussion by the Board.
26 MS. YEE: Actually, let me clarify that.
27 With respect to the discussion, do you want --
28 I mean, I was proposing two things, but I am open.

1 One would to be not include the letters to the
2 Journal in the rulemaking file to OAL --
3 MR. HORTON: So moved.
4 MS. YEE: Or -- okay.
5 MS. STEEL: Objection.
6 MS. YEE: What's that?
7 MS. STEEL: Objection.
8 MS. YEE: Okay, I'll second the motion.
9 Further discussion?
10 MS. MANDEL: Yeah.
11 MS. YEE: Ms. Mandel.
12 MS. MANDEL: I have a question for the -- well,
13 we're not at the point of making a rulemaking file
14 because the rulemaking file, as I understand it, doesn't
15 happen until this thing -- what we're doing now is we
16 are voting, if it gets approved, to send it into the
17 formal rulemaking process and that it's the start of
18 that formal rulemaking process with the notice that has
19 whatever it has in it, which Miss -- which they can tell
20 us -- because I'm having a brain freeze -- what really
21 goes into that and that the rulemaking file itself
22 doesn't include, necessarily, all of the informational
23 stuff that came to the Committee, which is why when we
24 go to formal hearing, people who have comments have to
25 make the same comments all over again.
26 Does that -- that's my understanding of where
27 the rulemaking file really is.
28 MR. HELLER: Ms. Mandel, if I could just add?

1 In -- generally, your understanding's correct,
2 the rulemaking file is prepared after the Board
3 authorizes publication.
4 However, as part of the initial statement of
5 reasons, we generally, as part of our procedure, we
6 identify the issue paper or Chief Counsel memorandum
7 that staff's submitted to the Board Members with all of
8 its recommendations as a document that the Board Members
9 relied upon in making their decision to go ahead and
10 approve publication of the recommendations set forth in
11 that document.
12 And, so, in this case, those -- all of the
13 exhibits -- I shouldn't say that -- the exhibits to our
14 issue paper include -- include the com -- all of the
15 comments from interested parties that we thought were
16 relevant for today. And, so, those, at least under our
17 current practice, those would be included as just -- it
18 would still be exhibits to the issue paper. And the
19 issue paper, under our current practice, would be
20 identified as a document that the Board relied upon.
21 But we can make it expressly clear that the Board did
22 not rely upon the statement of intent in the way that
23 the Board's already indicated, after we've identified
24 the issue paper itself as a document that the Board did
25 rely upon.
26 And, mainly, it's just because the Board -- we
27 do feel like in most cases the Board does rely on the
28 issue papers and Chief Counsel memos for the basis of

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1 the general analysis. And, so, that's our current
2 procedure. I just wanted to make the Board aware of it
3 in case -- and if you do want to instruct us to not
4 refer to the issue paper, we can.
5 It's just -- I'm not sure what the Office of
6 Administrative Law would think. They may still think
7 the Board relied on it and we should have identified it,
8 but we're certainly going to follow the Board's
9 direction and I just wanted to make that clear, so --
10 MS. YEE: All right. Thank you, Mr. Heller.
11 Motion by Mr. Horton, okay, I have seconded, to
12 authorize publication of the proposed amendments and
13 to --
14 MS. MANDEL: Can you -- can you just split it,
15 split the motion?
16 MS. YEE: Okay.
17 MS. MANDEL: You can --
18 MS. YEE: Mr. Horton, you want to remake the
19 motion?
20 MR. HORTON: Yes, sure -- bifurcate the motion,
21 the first motion is to -- wow, bifurcate it.
22 We would probably have to take the motion as-is
23 and if it fails, then take up the second motion because
24 they're interconnected, I would think.
25 Would that be your desire, Ms. Mandel?
26 MS. MANDEL: Well, I'm okay with the
27 amendments, I'm just -- I just think I'd abstain on the
28 other piece, so --

1 MR. HORTON: Okay.
2 MS. MANDEL: -- that's --
3 MR. HORTON: Move to -- move to adopt the
4 amendments as proposed -- well, strike that.
5 MS. YEE: Authorize publication.
6 MR. HORTON: I move to authorize publication,
7 with the exclusion of -- move to authorize publication,
8 as-is.
9 MS. YEE: Yeah, okay.
10 All right, we have a motion by Mr. Horton to
11 authorize publication of the proposed amendments.
12 I'll second that motion.
13 Please call the roll.
14 MS. OLSON: Ms. Yee?
15 MS. YEE: Aye.
16 MS. OLSON: Mr. Horton?
17 MR. HORTON: Aye.
18 MS. OLSON: Ms. Steel?
19 MS. STEEL: No.
20 MS. OLSON: Ms. Mandel?
21 MS. MANDEL: Aye.
22 MS. OLSON: Motion carries.
23 MS. YEE: Okay, second motion?
24 MR. HORTON: Move to exclude the -- what's the
25 letter called?
26 MS. YEE: Letters to the Journal.
27 MR. HORTON: Letters to the Journal as the
28 supporting documents for the amendments.

1 MS. YEE: Okay. Motion by Mr. Horton to
2 exclude the letters to the Journal, which -- Assembly
3 Journal, as supporting documents for the proposed
4 amendments.
5 I will --
6 MR. HORTON: In and of themselves.
7 MS. YEE: Yeah.
8 MR. HORTON: In and of themselves.
9 MS. YEE: I will second that motion.
10 Please call the roll.
11 MS. OLSON: Ms. Yee?
12 MS. YEE: Aye.
13 MS. OLSON: Mr. Horton?
14 MR. HORTON: Aye.
15 MS. OLSON: Ms. Steel?
16 MS. STEEL: No.
17 MS. OLSON: Ms. Mandel?
18 MS. MANDEL: Abstain.
19 MS. OLSON: Motion carries.
20 MS. YEE: Okay, I just want to be sure, is
21 staff -- are you clear about that?
22 MR. HELLER: We're very clear.
23 MS. YEE: Okay, thank you very much.
24 MR. HELLER: Thank you.
25 MS. YEE: That concludes the Business Taxes
26 Committee. Thank you very much.
27 MR. HORTON: Thank you.
28 ---o0o---

1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, JULI PRICE JACKSON, Hearing Reporter for the

8 California State Board of Equalization certify that on

9 FEBRUARY 28, 2012 I recorded verbatim, in shorthand, to

10 the best of my ability, the proceedings in the

11 above-entitled hearing; that I transcribed the shorthand

12 writing into typewriting; and that the preceding pages 1

13 through 33 constitute a complete and accurate

14 transcription of the shorthand writing.

15

16 Dated: March 19, 2012

17

18

19

20 JULI PRICE JACKSON

21 Hearing Reporter

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ESTIMATE OF COST OR SAVINGS RESULTING FROM PROPOSED REGULATORY ACTION

Proposed Amendment of Sales and Use Tax Regulation 1684, *Collection of Use Tax By Retailers*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement Prepared by _____ Date 4/6/12
Richard Bennion, Regulations Coordinator

Approved by _____ Date 4/6/12
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: **SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.**

Board Proceedings Division
10/7/05

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT

(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2008)

See SAM Section 6601 - 6616 for Instructions and Code Citations

DEPARTMENT NAME	CONTACT PERSON	TELEPHONE NUMBER
State Board of Equalization	Richard E. Bennion	916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400		**NOTICE FILE NUMBER**
Title 18, Section 1684, Collection of Use Tax by Retailers		Z

ECONOMIC IMPACT STATEMENT

A. ESTIMATED PRIVATE SECTOR COST IMPACTS (Include calculations and assumptions in the rulemaking record.)

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts businesses and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance
- ☐ g. Impacts individuals
- ☑ h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.)

h. (cont.) See Attached

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: _____ Describe the types of businesses (Include nonprofits.): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): _____

5. Enter the number of jobs created: _____ or eliminated: _____ Describe the types of jobs or occupations impacted: _____

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: _____

B. ESTIMATED COSTS (Include calculations and assumptions in the rulemaking record.)

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $ _____

a. Initial costs for a small business: $ _____ Annual ongoing costs: $ _____ Years: _____

b. Initial costs for a typical business: $ _____ Annual ongoing costs: $ _____ Years: _____

c. Initial costs for an individual: $ _____ Annual ongoing costs: $ _____ Years: _____

Describe other economic costs that may occur: _____

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): $ _____

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: _____ and the number of units: _____

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $ _____

C. ESTIMATED BENEFITS (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: _____

2. Are the benefits the result of : ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $ _____

D. ALTERNATIVES TO THE REGULATION (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: $ _____	Cost: $ _____
Alternative 1:	Benefit: $ _____	Cost: $ _____
Alternative 2:	Benefit: $ _____	Cost: $ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

Explain: _____

E. MAJOR REGULATIONS (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

1. Will the estimated costs of this regulation to California business enterprises exceed $10 million ? ☐ Yes ☐ No (If No, skip the rest of this section.)

Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 1:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 2:	$ _____	Cost-effectiveness ratio: $ _____

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT (Indicate appropriate boxes1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in _____, Budget Act of _____ or Chapter _____, Statutes of _____

☐ b. will be requested in the _____ (FISCAL YEAR) Governor's Budget for appropriation in Budget Act of _____

☐ Additional expenditures of approximately $ _____ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in _____

☐ b. implements the court mandate set forth by the _____

court in the case of _____ vs. _____

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. _____ at the _____ (DATE) election;

☐ d. is issued only in response to a specific request from the _____

_____, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the _____ (FEES, REVENUE, ETC.) authorized by Section

_____ of the _____ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

Savings of approximately $ _____ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

☑ 5. No fiscal impact exists because this regulation does not affect any local entity or program.

☐ 6. Other.

B. FISCAL EFFECT ON STATE GOVERNMENT *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year. It is anticipated that State agencies will:

☐ a. be able to absorb these additional costs within their existing budgets and resources.

☐ b. request an increase in the currently authorized budget level for the _____ fiscal year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any State agency or program.

☐ 4. Other.

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.

☐ 4. Other.

SIGNATURE ✍		TITLE Regulations Coordinator
AGENCY SECRETARY [1] APPROVAL/CONCURRENCE	✍ Jeann Richmond	DATE 3/27/12
DEPARTMENT OF FINANCE [2] APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER ✍ Exempt under SAM section 6660	DATE

1. *The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.*

2. *Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.*

Addendum to Economic and Fiscal Impact Statement (STD. 399 (Rev. 12/2008)) for the Proposed Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

Revenue and Taxation Code sections (sections) 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers. Also, section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203.

California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*, currently requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board. (Regulation 1684 does not regulate the health and welfare of California residents, worker safety, or the state's environment.)

Section 6203, subdivision (c), as amended by Assembly Bill No. 155 (Stats. 2011, ch. 313.), will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and the amendments made to subdivision (c) by AB 155 will become operative on either September 15, 2012, or January 1, 2013. Once new subdivision (c) is operative, subdivision (c) will provide that the term "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty" and provide that retailers with substantial nexus, include, but are not limited to, retailers with commonly controlled group and affiliate nexus (as discussed in detail in the initial statement of reasons). Therefore, a retailer that has a "substantial nexus" with California, including a retailer with commonly controlled group nexus or affiliate nexus, will be required to register with the Board to collect California use tax when the amendments made to section 6203, subdivision (c) by AB 155 become operative, regardless of whether the Board adopts amendments to Regulation 1684.

The Board's proposed amendments to Regulation 1684 will help retailers better understand whether they are obligated to register to collect California use tax when the amendments made to section 6203, subdivision (c) by AB 155 become operative by:

- Making Regulation 1684 consistent with the amendments made to section 6203 by AB 155;
- Providing notice to retailers that California will be a "substantial nexus state" and that a retailer with a physical presence in California will be required to register to collect California use tax when the amendments made to section 6203 by AB 155 are operative, unless the retailer can show that its physical presence is so slight that Article I, section 8, clause 3 of the United States Constitution (the Commerce Clause) will not permit California to impose a use tax collection obligation on the retailer or the retailer is otherwise exempt from the requirement to register to collect use tax;

- Incorporating the new commonly controlled group nexus provisions added to section 6203, subdivision (c)(4), by AB 155, defining the phrase "in cooperation with" as used in subdivision (c)(4), and clarifying that subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property;
- Incorporating the new affiliate nexus provisions added to section 6203, subdivision (c)(5), by AB 155; clarifying the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5); clarifying that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5) shall be made at the end of each calendar quarter; clarifying that, for purposes of section 6203, subdivision (c)(5), an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf; clarifying that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California; creating a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications; defining the terms "advertisement," "individual," "person," "solicit," and "solicitation" for purposes of applying section 6203, subdivision (c)(5); and providing examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5); and
- Providing notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state (as discussed in detail in the initial statement of reasons.)

Furthermore, the Board's proposed amendments to Regulation 1684 are consistent with section 6203, as amended by AB 155, the proposed amendments will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect, and the proposed amendments will not impose any new taxes or expand any retailer's use tax collection obligation beyond the use tax collection obligation imposed by new section 6203 when the amendments made to section 6203 by AB 155 become operative (as discussed in detail in the initial statement of reasons). Therefore, based upon the foregoing information and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1684:

- Will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states;
- Will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California;

- Will not have a significant effect on housing costs;
- Will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California; and
- Will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

In addition, the Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action, separate and apart from compliance with the amendments made to section 6203 by AB 155.

STATE OF CALIFORNIA–OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-09)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2012-0327-05		

For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

MAR 27 '12 APR 06 '12

Office of Administrative Law

NOTICE | REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY: State Board of Equalization

AGENCY FILE NUMBER (If any):

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
Collection of Use Tax by Retailers	18	1684	April 6, 2012

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
[X] Notice re Proposed Regulatory Action [ ] Other	Rick Bennion	(916) 445-2130	(916) 324-3984

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	[ ] Approved as Submitted [ ] Approved as Modified [ ] Disapproved/ Withdrawn		

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT

AMEND

TITLE(S)

REPEAL

3. TYPE OF FILING

[ ] Regular Rulemaking (Gov. Code §11346)

[ ] Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)

[ ] Emergency (Gov. Code, §11346.1(b))

[ ] Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.

[ ] Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)

[ ] Emergency Readopt (Gov. Code, §11346.1(h))

[ ] File & Print

[ ] Other (Specify) _____

[ ] Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)

[ ] Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

[ ] Effective 30th day after filing with Secretary of State

[ ] Effective on filing with Secretary of State

[ ] §100 Changes Without Regulatory Effect

[ ] Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

[ ] Department of Finance (Form STD. 399) (SAM §6660)

[ ] Fair Political Practices Commission

[ ] State Fire Marshal

[ ] Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY

For use by Office of Administrative Law (OAL) only

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*. Regulation 1684 implements, interprets, and makes specific the provisions of RTC sections 6203 and 6226, which collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers, and RTC section 6204, which makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. The proposed amendments make the regulation consistent with, further clarify, and implement the amendments made to RTC section 6203 by Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313.), which changed the definition of "retailer engaged in business in this state."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 30 - 31, 2012. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on May 30 or 31, 2012. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1684.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6203.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing Federal Law Regarding the Collection of State Use Tax

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Further, the United States Supreme Court has historically agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has

also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

In addition, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556); and the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.) (The initial statement of reasons contains a more detailed discussion of federal and state case law regarding substantial nexus.)

Current California Law Regarding the Collection of Use Tax

Currently, RTC sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers. Also, RTC section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board, as required.

Currently, the operative provisions of RTC section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e), provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in RTC section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Currently, Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e), regarding convention and tradeshow activities.

RTC Section 6203 as Amended by AB 155

RTC section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

RTC section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group," as defined in RTC section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulation 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to RTC section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to RTC section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that

person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to RTC section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

The amendments made to RTC section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1684

Board staff conducted meetings with interested parties on October 31 and December 20, 2011, in Sacramento, California, and November 2 and December 22, 2011, in Culver City, California, to discuss the effect of the amendments made to RTC section 6203 by AB 155 and how to best amend Regulation 1684 to make it consistent with the amendments to section 6203, implement the new provisions that were added to RTC section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that AB 155 will require retailers to register to collect California use tax if they have a "substantial nexus" with California.

After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of RTC section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-

exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;

- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California;

- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5), by utilizing contractual terms and factual certifications; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Define the term "person" by reference to the definition of "person" set forth in RTC section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.) The proposed amendments are anticipated to provide the following specific benefits:

- Ensure that Regulation 1684 is consistent with the amendments made to section 6203 by AB 155 when the amendments made to section 6203 become operative;
- Ensure that the amendments made to section 6203 by AB 155 are interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Scripto*, and *National Geographic Society*;

- Ensure that section 6203's new affiliate nexus provisions will be interpreted and administered consistently;
- Provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board to collect use tax; and
- Provide more certainty to retailers regarding their new use tax collection obligations before the amendments made to section 6203 by AB 155 becomes operative.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1684 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1684 is the only state regulation prescribing retailers' obligations to collect California use tax. In addition, there is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1684.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The adoption of the proposed amendments to Regulation 1684 will making Regulation 1684 consistent with the amendments to RTC section 6203 made by AB 155, clarify and implement the new provisions that were added to section 6203 by AB 155 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that section 6203 will require retailers to register to collect California use tax if they have a "substantial nexus" with California once the amendments made by AB 155 become operative. The proposed amendments will not impose any new taxes or expand any retailers' use tax collection obligation beyond that imposed by section 6203 as amended by AB 155. Therefore, the Board has made an

initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1684 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1684 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on May 30, 2012, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1684 during the May 30 - 31, 2012, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1684. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1684 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1684 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1684, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1684

Section 1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances~~this state is a "retailer engaged in business in this state" and~~ the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee); or~~.~~

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a

person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and

links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by a~~n out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a

substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(3~~b~~) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(A~~1~~) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(B~~2~~) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(e~~e~~) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(f~~d~~) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(g~~e~~) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(h~~f~~) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

Bennion, Richard

From: BOE-Board Meeting Material
Sent: Friday, April 06, 2012 8:38 AM
To: Alonzo, Mary Ann (Legal); Anderson, Karen E.; Angeles, Joel; Bartolo, Lynn; Bennion, Richard; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boring, Dilara; Carey, Lynne; Chung, Sophia (Legal); Davis, Toya P.; Delgado, Maria; Duran, David; Elliott, Claudia; Epolite, Anthony (Legal); Evans, Regina; Ferris, Randy (Legal); Garcia, Laura; Gau, David; Gilman, Todd; Giorgi, Dolores; Goehring, Teresa; Hale, Mike; Hall, Gail; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Ingenito, Robert; Jacobson, Andrew; Kinkle, Sherrie L; Kuhl, James; Lambert, Robert (Legal); Levine, David H. (Legal); LoFaso, Alan; Maddox, Ken; Madrigal, Claudia; Maeng, Elizabeth; Mandel, Marcy Jo; Matsumoto, Sid; Mayhew, Heather; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Ralston, NaTasha; Richmond, Joann; Riley, Denise (Legal); Schultz, Glenna; Scott, Megan; Shah, Neil; Singh, Sam; Smith, Rose; Stowers, Yvette; Suero-Gabler, Cynthia; Thomas, Robert; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Vasquez, Rosalyn; Vasquez, Rosalyn; Wallentine, Sean; Whitaker, Lynn; Williams, Lee; Worley, Tabitha; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 1684

The State Board of Equalization proposes to amend Sales and Use Tax Regulation 1684, *Collection of Use Tax by Retailers.* A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on Wednesday, May 30, 2012.

The proposed amendments make the regulation consistent with, clarify, and implement the amendments made to Revenue and Taxation Code section 6203 by AB 155 (Stats. 2011, ch. 313), which changed the definition of "retailer engaged in business in this state."

To view the notice of proposed regulatory action, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1684_2012.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Bradley Heller, Tax Counsel IV, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Bradley.Heller@boe.ca.gov, telephone (916) 323-3091, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion
Regulations Coordinator
Phone (916) 445-2130
Fax (916) 324-3984
Richard.Bennion@boe.ca.gov

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change [StateBoardofEqualization-AnnouncementofRegulatoryChange@BOE.CA.GOV]
Sent: Friday, April 06, 2012 10:57 AM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 1684

The State Board of Equalization proposes to amend Sales and Use Tax Regulation 1684, *Collection of Use Tax by Retailers.* A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on Wednesday, May 30, 2012.

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Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

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above when it has been received from the agency program staff.

Impact of Regulatory Action/Results of the Economic Impact Analysis

The potential for significant statewide adverse economic impacts that might result from the proposed regulatory action has been assessed, and the following initial determinations relative to the required statutory categories have been made:

(a) Significant Statewide Adverse Economic Impact Directly Affecting Businesses, Including the Ability of California Businesses to Compete with Businesses in Other States:

The proposed action will not have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. There are no economic or business impacts foreseen or associated with the proposed regulation change.

(b) Impact on the Creation or Elimination of Jobs Within the State, the Creation of New Businesses or the Elimination of Existing Businesses, or the Expansion of Businesses in California; Benefits of the Regulation to the Health and Welfare of California Residents, Worker Safety, and the State's Environment:

The Commission does not anticipate any impacts on the creation or elimination of jobs, the creation of new business, the elimination of existing businesses or the expansion of businesses in California.

The Commission does not anticipate any benefits to the health and welfare of California residents.

The Commission does not anticipate any non–monetary benefits to worker safety.

The Commission does not anticipate any benefits to the environment.

(c) Cost Impacts on a Representative Private Person or Business:

The agency is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

(d) Costs or Savings to State Agencies or Costs/Savings in Federal Funding to the State:

None.

(e) Nondiscretionary Costs/Savings to Local Agencies:

None.

(f) Programs Mandated on Local Agencies or School Districts:

None.

(g) Costs Imposed on Any Local Agency or School District that are Required to be Reimbursed Under Part 7 (commencing with Section 17500) of Division 4, Government Code:

None.

(h) Effect on Housing Costs:

None.

Effect on Small Business

It has been determined that the adoption of these regulations may affect small business. The Commission has drafted the regulations in Plain English pursuant to Government Code sections 11342.580 and 11346.2(a)(1).

Consideration of Alternatives

The Commission must determine that no reasonable alternative considered by the Commission, or that has otherwise been identified and brought to the attention of the Commission, would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost–effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*. Regulation 1684 implements, interprets, and makes specific the provisions of RTC sections 6203 and 6226, which collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers, and RTC section 6204, which makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. The proposed amendments make the regulation consistent

with, further clarify, and implement the amendments made to RTC section 6203 by Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313), which changed the definition of "retailer engaged in business in this state."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 30–31, 2012. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on May 30 or 31, 2012. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1684.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6203.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing Federal Law Regarding the Collection of State Use Tax

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317–318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Further, the United States Supreme Court has historically agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out–of–state retailer that has established a place of business in the taxing state, even if the retailer's in–state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560–561.) This is so regardless of whether the connection involves an in–state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211–212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society, supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

In addition, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society, supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the

California Supreme Court's slightest presence standard on appeal (*National Geographic Society, supra*, 430 U.S. at p. 556); and the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill, supra*, 504 U.S. at p. 315, fn. 8.) (The initial statement of reasons contains a more detailed discussion of federal and state case law regarding substantial nexus.)

Current California Law Regarding the Collection of Use Tax

Currently, RTC sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers. Also, RTC section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board, as required.

Currently, the operative provisions of RTC section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
>
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e), provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in RTC section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out–of–state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On–line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out–of–state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Currently, Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, sub-

division (e), regarding convention and tradeshow activities.

RTC Section 6203 as Amended by AB 155

RTC section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

RTC section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group," as defined in RTC section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulation 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer. . . ."

In addition, subdivision (c)(5)(A), as added to RTC section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to RTC section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to RTC section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

The amendments made to RTC section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1684

Board staff conducted meetings with interested parties on October 31 and December 20, 2011, in Sacramento, California, and November 2 and December 22, 2011, in Culver City, California, to discuss the effect of

the amendments made to RTC section 6203 by AB 155 and how to best amend Regulation 1684 to make it consistent with the amendments to section 6203, implement the new provisions that were added to RTC section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that AB 155 will require retailers to register to collect California use tax if they have a "substantial nexus" with California.

After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of RTC section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non–exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)–(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California;
- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5), by utilizing contractual terms and factual certifications; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and

broad nature of advertising and the more actively targeted nature of soliciting;

- Define the term "person" by reference to the definition of "person" set forth in RTC section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus–expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.) The proposed amendments are anticipated to provide the following specific benefits:

- Ensure that Regulation 1684 is consistent with the amendments made to section by AB 155 when the amendments made to section 6203 become operative;
- Ensure that the amendments made to section 6203 by AB 155 are interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess, Quill, Scripto*, and *National Geographic Society*;
- Ensure that section 6203's new affiliate nexus provisions will be interpreted and administered consistently;
- Provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board to collect use tax; and
- Provide more certainty to retailers regarding their new use tax collection obligations before the amendments made to section 6203 by AB 155 becomes operative.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1684 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1684 is the only state regulation prescribing retailers' obligations to collect California use tax. In addition, there is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1684.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non–discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The adoption of the proposed amendments to Regulation 1684 will making Regulation 1684 consistent with the amendments to RTC section 6203 made by AB 155, clarify and implement the new provisions that were added to section 6203 by AB 155 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that sec-

tion 6203 will require retailers to register to collect California use tax if they have a "substantial nexus" with California once the amendments made by AB 155 become operative. The proposed amendments will not impose any new taxes or expand any retailers' use tax collection obligation beyond that imposed by section 6203 as amended by AB 155. Therefore, the Board has made an initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1684 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1684 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on May 30, 2012, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1684 during the May 30-31, 2012, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1684. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscore and strikeout version of the text of Regulation 1684 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all

the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terns of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1684 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1684, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.

TITLE 18. FRANCHISE TAX BOARD

As required by Section 11346.4 of the Government Code, this is notice of intention to consider the adoption of section 19089 in Title 18 of the California Code of Regulations, pertaining to notice requirements for bankruptcy or receivership fiduciaries. There will not be a public hearing unless requested by an interested person at least 15 days before the close of the written comment period. Any request for a public hearing should be submitted to the agency officer named below. Government Code section 15702, subdivision (b), provides for consideration by the three–member Franchise Tax Board of any proposed regulatory action if any person makes such request in writing.

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., May 24, 2012. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

AUTHORITY AND REFERENCE

Revenue and Taxation Code section 19503 authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001) and Part 11 (commencing with section 23001). Revenue and Taxation Code section 19089 requires adoption of this regulation in order to implement the notice requirements specified in that section.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Revenue and Taxation Code section 19089 provides, in part, that "[e]very trustee in a case under Title 11 of the United States Code, receiver, assignee for the benefit of creditors or like fiduciary shall give notice of qualification as such to the Franchise Tax Board in the manner and at the time that may be required by regulations of the Franchise Tax Board" and that "[t]he Franchise Tax Board may by regulation provide any exemptions from the requirements of this section that the Franchise Tax Board deems proper." The Franchise Tax Board has not adopted regulations under this section. The proposed new regulation is designed to implement this section.

The proposed regulation is modeled after Treasury Regulation section 301.6036–1, and implements the notice requirement for bankruptcy or receivership fiduciaries. The proposed regulation is modified from the federal regulation language to eliminate the requirement to give notice in probate cases, since Probate Code section 9202, subdivision (c), already specifies the notice required in estate administration under California probate law.

The proposed language for this regulation addresses who is required to give notice of qualification as a fiduciary in bankruptcy and receivership proceedings; the manner in which parties must provide the Franchise Tax Board with notice; the time requirement for providing the Franchise Tax Board with notice; whether any exemptions to the notice requirement may be appropriate; and the notice to the Franchise Tax Board of administration of bankruptcy by fiduciaries, thereby aiding tax collection functions as anticipated by Revenue and Taxation Code section 19089.

STATE OF CALIFORNIA

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Executive Director

April 6, 2012

To Interested Parties:

Notice of Proposed Regulatory Action
by the
State Board of Equalization

Proposed to Adopt Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*. Regulation 1684 implements, interprets, and makes specific the provisions of RTC sections 6203 and 6226, which collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers, and RTC section 6204, which makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. The proposed amendments make the regulation consistent with, further clarify, and implement the amendments made to RTC section 6203 by Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313.), which changed the definition of "retailer engaged in business in this state."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 30 - 31, 2012. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on May 30 or 31, 2012. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1684.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6203.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing Federal Law Regarding the Collection of State Use Tax

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Further, the United States Supreme Court has historically agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales

of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

In addition, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556); and the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.) (The initial statement of reasons contains a more detailed discussion of federal and state case law regarding substantial nexus.)

Current California Law Regarding the Collection of Use Tax

Currently, RTC sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers. Also, RTC section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board, as required.

Currently, the operative provisions of RTC section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e), provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in RTC section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Currently, Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e), regarding convention and tradeshow activities.

RTC Section 6203 as Amended by AB 155

RTC section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

RTC section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group," as defined in RTC section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulation 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to RTC section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to RTC section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in

this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to RTC section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

The amendments made to RTC section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1684

Board staff conducted meetings with interested parties on October 31 and December 20, 2011, in Sacramento, California, and November 2 and December 22, 2011, in Culver City, California, to discuss the effect of the amendments made to RTC section 6203 by AB 155 and how to best amend Regulation 1684 to make it consistent with the amendments to section 6203, implement the new provisions that were added to RTC section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that AB 155 will require retailers to register to collect California use tax if they have a "substantial nexus" with California.

After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of RTC section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within

the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California;

- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5), by utilizing contractual terms and factual certifications; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Define the term "person" by reference to the definition of "person" set forth in RTC section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.) The proposed amendments are anticipated to provide the following specific benefits:

- Ensure that Regulation 1684 is consistent with the amendments made to section 6203 by AB 155 when the amendments made to section 6203 become operative;

- Ensure that the amendments made to section 6203 by AB 155 are interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Scripto*, and *National Geographic Society*;
- Ensure that section 6203's new affiliate nexus provisions will be interpreted and administered consistently;
- Provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board to collect use tax; and
- Provide more certainty to retailers regarding their new use tax collection obligations before the amendments made to section 6203 by AB 155 becomes operative.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1684 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1684 is the only state regulation prescribing retailers' obligations to collect California use tax. In addition, there is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1684.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The adoption of the proposed amendments to Regulation 1684 will making Regulation 1684 consistent with the amendments to RTC section 6203 made by AB 155, clarify and implement the new provisions that were added to section 6203 by AB 155 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that section 6203 will require retailers to register to collect California use tax if they have a

"substantial nexus" with California once the amendments made by AB 155 become operative. The proposed amendments will not impose any new taxes or expand any retailers' use tax collection obligation beyond that imposed by section 6203 as amended by AB 155. Therefore, the Board has made an initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1684 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1684 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at

Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on May 30, 2012, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1684 during the May 30 - 31, 2012, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1684. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1684 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1684 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting

amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1684, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the May 30, 2012 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Initial Statement of Reasons

Adoption of Proposed Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

SPECIFIC PURPOSE AND NECESSITY

Current Regulation 1684 and Current Section 6203

California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*, requires "[r]etailers engaged in business in this state as defined in Section 6203" of the Revenue and Taxation Code (section[1] 6203) to register with the State Board of Equalization (Board), collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board.

Current Provisions of Section 6203
Currently, the operative provisions of section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state. (Current section 6203, subd. (c)(1)-(3).)

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a

[1] All further section references are to the Revenue and Taxation Code, unless otherwise indicated.

> computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e) provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Current Provisions of Regulation 1684

Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e) regarding convention and tradeshow activities.

Section 6203 as Amended by Assembly Bill No. 155

Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313) was enacted on September 23, 2011, and section 3 of AB 155 will amend the definition of "retailer engaged in business in this state," as set forth in current section 6203. Section 6 of AB 155 provides that the amendments made to section 6203 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. However, if a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

Section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group" as defined in section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulations 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to section 6203 by AB 155 will also repeal the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

Substantial Nexus

Physical Presence Test

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing

state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and

- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Historically, the United States Supreme Court has agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

Further, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556). Subsequently, the United States Supreme Court held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.)

More recently, the Court of Appeals of New York (i.e., New York's highest appellate court) explained that, while the "physical presence" test affirmed in *Quill* requires that a retailer have more than the slightest physical presence in a state before that state can require the retailer to collect the state's use tax, the physical presence "does not need to

be substantial" and "it may be manifested by the presence in the taxing State of the [retailer's] property or the conduct of economic activities in the taxing State performed by the [retailer's] personnel or on its behalf." (*Orvis Co., Inc., v. Tax Appeals Tribunal of the State of New York et al.* (1995) 86 N.Y.2d 165, 178.) Furthermore, the California Court of Appeal expressly agreed with and followed the Court of Appeals of New York's construction of the physical presence test in *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179, 1198-1199. And, the California Court of Appeal further explained that activities performed in California by or on behalf of a retailer will be sufficient to satisfy the physical presence test if they enhance the retailer's sales to California customers and significantly contribute to the retailer's ability to establish and maintain a market in California. (*Id.* at p. 1196.)

Commonly Controlled Group Nexus

The Board is aware that, in *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, the California Court of Appeal held that an out-of-state corporate retailer with no stores, solicitors, or property within California does not have a physical presence in California solely because it is acquired by another corporation that is a retailer with a physical presence. However, in that case, the California retailer's activities did not give the out-of-state retailer a physical presence in California because:

- Neither entity was the alter ego or agent of the other for any purpose;
- Neither entity solicited orders for the products of the other, and neither accepted returns of the merchandise of the other or otherwise assisted or provided services for customers of the other;
- Each entity owned, operated, and maintained its own business assets, conducted its own business transactions, hired and paid its own employees, and maintained its own accounts and records;
- Neither entity held itself out to customers or potential customers as being the same as, or an affiliate of, the other;
- Each entity had its own trade name, goodwill, marketing practices and customer lists and marketed its products independently of the other; and
- Neither purchased goods or services from the other. (*Id.* at p. 388.)

The Board does not believe that the holding in *Current* affects the validity of the new commonly controlled group nexus provisions of section 6203, subdivision (c)(4), that will become operative on September 15, 2012, or January 1, 2013, which provide that a retailer is engaged in business in California if: (1) the retailer is a member of a commonly controlled group, as defined in section 25105; and (2) the retailer is a member of a combined reporting group, as defined in Franchise Tax Board Regulation 25106.5, subdivision (b)(3), that includes "another member of the retailer's commonly controlled group that, ***pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer***, including, but not limited to, design and development of tangible personal

property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer." (Emphasis added.)

This is because the United States Supreme Court agreed with the Washington Supreme Court, in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, 250-251, that a retailer has a substantial nexus with a taxing state if there are persons in that state performing activities on behalf of the retailer that enable the retailer to "establish and maintain a market." Additionally, in 2005, the California Court of Appeal subsequently quoted *Tyler Pipe* before concluding that an out-of-state retailer organized as a limited liability company (LLC) had a substantial nexus with California because a separate corporation, affiliated with the LLC through a common parent, performed activities in California on behalf of the retailer that were significantly associated with the retailer's ability to establish and maintain its California market. (*Borders Online*, *supra*, 129 Cal.App.4th at pp. 1196, 1197.) Accordingly, the Board believes that the California Court of Appeal's holding in *Current* would have been different if the in-state corporation had performed services in California in connection with tangible personal property to be sold by the out-of-state corporation, pursuant to an agreement with or in cooperation with the out-of-state corporation (i.e., if the provisions of section 6203, subdivision (c)(4) (emphasized above) had been operative and satisfied in that case).

Affiliate Nexus

The State of New York has enacted an affiliate nexus statute that is similar to the provisions of section 6203, subdivision (c)(5), as add by AB 155. The New York statute creates a rebuttable presumption that a retailer is soliciting business in New York through an independent contractor or other representative and is required to register to collect New York use tax if the retailer enters into an agreement with a resident of New York under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the retailer's cumulative gross receipts from sales to customers in New York who were referred to the retailer by residents with the requisite agreements is in excess of $10,000 during the four proceeding quarters. (N.Y. Tax Law § 1101, subd. (b)(8)(vi).) The New York statute also provides that the presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer "that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question." (*Ibid.*)

Amazon.com LLC filed a lawsuit in New York seeking declaratory and injunctive relief on the ground that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; however, when the Supreme Court of New York County (i.e., a New York trial court) denied the relief, Amazon.com LLC dropped its facial challenge and appealed the trial court's decision on other grounds, including the ground that the New York statute allegedly violates the Commerce Clause as applied to Amazon.com LLC. (*Amazon.com, LLC, et al. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.) Overstock.com, Inc. also filed a lawsuit in New York seeking injunctive and declaratory relief on the ground

that that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; and when the Supreme Court of New York County denied the relief, Overstock.com, Inc. argued that the statute allegedly violates the Commerce Clause both on its face and as applied to Overstock, Inc. when it appealed the Supreme Court of New York County's decision. (*Overstock.com, Inc. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.)

Amazon.com, LLC's and Overstock.com, Inc.'s appeals were consolidated into one matter before the Appellate Division of the Court of Appeals of New York (i.e., an intermediate appellate court) and jointly decided on November 4, 2010. (2010 N.Y. Slip Opn. 7823.) In that decision, the Appellate Division denied Overstock.com, Inc.'s facial challenge because the court concluded that the New York statute is consistent with the "physical presence" test, which was affirmed in *Quill* and discussed at length in *Orvis*, in that the New York statute only requires a retailer to register to collect New York use tax if the retailer enters into a business-referral agreement with a New York resident, the resident actively solicits business in New York, as opposed to merely posting a passive advertisement, and the resident receives a commission based upon the sales successfully solicited in New York. (2010 N.Y. Slip Opn. 7823, at pp. 8-10.) However, the Appellate Division remanded the as-applied challenges back to the trial court for discovery.

The Board believes that, after remand back to the trial court for further factual development, both Amazon.com, LLC and Overstock.com, Inc. may continue to press their objections to the Appellate Division's decision to the Court of Appeals of New York (i.e., New York's highest appellate court). However, in the meantime, the New York State Department of Taxation and Finance has issued Technical Services Bureau Memorandum TSB-M-08(3)S (May 8, 2008), which explains the rebuttable presumption in the New York statute and provides that the "Tax Department will deem the presumption rebutted where the [retailer] is able to establish that the only activity of its resident representatives in New York State on behalf of the [retailer] is a link provided on the representatives' Web sites to the [retailer's] Web site and none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the [retailer]." And, TSB-M-08(3)S further provides that "an agreement to place an advertisement does not give rise to the presumption"; however, "placing an advertisement does not include the placement of a link on a Web site that, directly or indirectly, links to the Web site of a [retailer], where the consideration for placing the link on the Web site is based on the volume of completed sales generated by the link."

The New York State Department of Taxation and Finance also issued Technical Services Bureau Memorandum TSB-M-08(3.1)S (June 30, 2008), which provides that a retailer may rebut the presumption that it has nexus under the New York statute by meeting both of the following conditions:

1. Contract condition – Showing that the contract or agreement between the retailer and the resident representative provides that the resident representative is prohibited from engaging in any solicitation activities in New York that refer potential customers to

the retailer, including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails, and, if the resident representative is an organization (such as a club or a nonprofit group), showing that the contract or agreement also provides that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above; and

2. Proof of compliance condition – Showing that each resident representative has submitted to the retailer, on an annual basis, a signed certification stating that the resident representative has not engaged in any prohibited solicitation activities in New York, as described above, at any time during the previous year, and, if the resident representative is an organization, that the annual certification also include a statement from the resident organization certifying that its Web site includes information directed at its members alerting them to the prohibition against each of the solicitation activities described above.

However, as to the proof of compliance condition, a signed certification from a resident representative may only be used to rebut the presumption in the New York statute if the retailer accepts it in good faith (i.e., the retailer does not know or have reason to know that the certificate is false or fraudulent).

In addition, the Board is aware that subdivision (a)(1) of Regulation 1540, *Advertising Agencies and Commercial Artists*, provides that: "Advertising is commercial communication utilizing one or more forms of communication (such as television, print, billboards, or the Internet) from or on behalf of an identified person to an intended target audience." The Board is also aware that, in the administrative appeal of Barnes & Noble.com, LLC, the Board had to determine whether certain in-state activity constituted "advertising" or "selling." In the Memorandum Opinion the Board adopted to decide the Barnes & Noble.com appeal, the Board stated that "an 'advertisement' is a 'written, verbal, pictorial, graphic, etc., announcement of goods or services for sale, employing purchased space or time in print or electronic media.'" However, the Board also concluded that when California employees of Barnes & Noble Booksellers, Inc. (B&N Booksellers), physically distributed coupons to B&N Booksellers' customers, which could only be used to make discounted purchases from Barnes & Noble.com (B&N.com), the acts of physically distributing the coupons directly to the potential customers of B&N.com were solicitations of those persons, and went beyond mere advertising to the public at large. (Memorandum Opinion, *Barnes & Noble.com*, adopted September 12, 2002.)

Furthermore, the Board is aware that Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) provides that the word "advertise" means "[t]o make known to the public through a medium of publicity that one's goods or services are available for sale or engagement." In addition, Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) defines the word "solicit" as "to invite a business transaction" or "[t]o importune, entreat, implore, ask, attempt, or try to obtain an order" and defines the phrase "solicitation of business" as "seeking orders for goods or services."

Adoption of Regulation 1684's Current Website Provisions
The Board adopted the current provisions of Regulation 1684, subdivision (a), regarding computer servers, websites, and Internet service providers on September 10, 1997. The Final Statement of Reasons for the adoption of the provisions provides that:

> In recent years, two business practices have arisen which raise the issue as to whether or not the retailers practicing them thus became engaged in business in this state. First, some out-of-state retailers have established Web Sites (electronic files maintained on computers called servers) on the World Wide Web, part of the Internet, for the purpose of making sales. The Internet evolved from a Defense Department project in the late 1960's, and has grown to be a world-spanning network of at least 60,000 smaller, independent computer networks linked by satellites, coaxial cable, and phone lines. The World Wide Web is a smaller network of hyperlinked documents within the Internet. (Yahoo! Internet Life (8/97), p. 62) Servers mainly belong to service providers, either Independent Service Providers (ISP's), or national commercial on-line services like Prodigy or America On-Line. The server on which the Web Site is located may or may not be sited in California. Confusion has arisen as to whether or not an in-state ISP who hosts an out-of-state retailer's Web Site is a "representative" within the meaning of Section 6203(b) for use tax collection purposes and, if so, whether the exemption contained in Section 6203(j), whereby nexus is not provided by a retailer's use of an on-line service for the purpose of taking orders for tangible personal property if the primary purpose of the service is not the sale of tangible personal property, applies to a retailer's Web Site carried by a general-interest ISP which hosts a myriad of Web Sites as well as to a proprietary on-line service. Legislation has been introduced to clarify these principles, but none has yet been enacted. As more and more business is being conducted on the Internet, the Board concluded that it was necessary to resolve this issue by regulation to bring some certainty to this area pending legislative action. Upon consultation with industry, the Board concluded that a Web Site is a utility service operating through communications lines to forward a buyer's order to the retailer, so that orders placed through a Web Site should be treated for nexus purposes like orders placed through the mail which the United States Supreme Court has determined does not provide "nexus." (Quill Corporation v. North Dakota (1992) 504 U.S. 298.) The Board also concluded that the Legislature did intend that Section 6302(j) apply to Web Sites hosted by ISP's as well as to proprietary networks.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a), regarding the use of computer servers, websites, and Internet service providers was based upon the Board's 1997 interpretation of *Quill* and not solely the express language of subdivision (d) of current section 6203, which will be inoperative on September 15, 2012, or January 1, 2013, due to the provisions of AB 155. However, the

Board's Legal Department's current opinion is that an out-of-state retailer that owns a computer server in California (as opposed to merely purchasing web services through a third party's servers) has a place of business in California where the server is located and is, thus, obligated to collect California use tax, under the current (and continuing) provisions of section 6203, subdivision (c)(1).

Warranty and Repair Services
The Board adopted the current provisions of Regulation 1684, subdivision (a), regarding warranty and repair services on September 10, 1997. The Final Statement of Reasons for the adoption of the provisions provides that:

> [M]any retailers have entered into contracts with instate businesses to perform repair services on such retailers' products purchased by buyers who are residents of this state.
>
> Again, a controversy has arisen as to whether or not these independent contractors are "representatives" of such retailers within the meaning of Section 6203(b) for use tax collection purposes. Upon researching this issue, the Board determined that such repairmen do not qualify under established United States Supreme Court cases as representatives for nexus purposes because they do not participate in the transfer of the property from the out-of-state retailer to the in-state customer but, rather, become involved with the property after (sometimes long after) the sale transaction is concluded. As more and more out-of-state retailers are out-sourcing their warranty responsibilities to instate independent contractors rather than maintaining in-state repair facilities, and no statute addresses this issue, the Board concluded that it was necessary for it to bring certainty to this issue by regulatory action.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding warranty and repair services was based upon the Board's 1997 interpretation of United States Supreme Court cases.

Interested Parties Process

Initial Interested Parties Meetings
During the Board's Business Taxes Committee meeting on July 26, 2011, the Board directed its staff to review ABx1 28 (Stats. 2011, ch.7), which made almost identical amendments to section 6203 as AB 155 and conduct interested parties meetings to discuss whether the Board should amend Regulation 1684 to implement, interpret, and make specific the amendments made to section 6203 by ABx1 28. However, before staff could begin the interested parties process, the Legislature repealed the amendments made to section 6203 by ABx1 28 and enacted the amendments made to section 6203 by AB 155 (discussed above). Therefore, Board staff reviewed AB 155 and Regulation 1684 and then conducted meetings with interested parties on October 31, 2011, in Sacramento,

California, and November 2, 2011, in Culver City, California, to discuss staff's initial suggestions that Regulation 1684 needs to be amended to:

- Incorporate the new provisions of section 6203 regarding substantial nexus, including provisions addressing commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess* (and affirmed in *Quill*) by creating a rebuttable presumption that, unless otherwise provided in Regulation 1684, a retailer is required to collect California use tax if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier or the United States mail or interstate telecommunication;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new provisions of section 6203 by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Explain that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in the new affiliate nexus provisions of section 6203, refer to commissions or other consideration that is based upon completed sales of tangible personal property, similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;
- Create a means by which a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203 by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident;
- Clarify that an out-of-state retailer that owns a computer server in California and uses the California server to maintain its webpage where it makes retail sales (as opposed to a retailer that merely purchases web services through a third party's servers) has a substantial nexus with California (i.e., a place of business in California where the server is located) and is, thus, obligated to collect California use tax; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

And, to discuss Board staff's initial suggestions that the Board:

- Retain the current provisions of Regulation 1684 regarding Internet service providers, online service providers, internetwork communication service providers, other Internet access service providers, and World Wide Web hosting services based upon the Board's 1997 interpretation of *Quill*; and

- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

After reviewing Board's staff's suggestions, the interested parties recommended:

- Revising staff's suggested amendments adding subdivision (c)(2) to Regulation 1684 to incorporate the commonly controlled group nexus provisions of new section 6203, subdivision (c)(4), so that subdivision (c)(2) of the regulation defines the phrase "in cooperation with," as used in new section 6203, subdivision (c)(4), so that it only refers to activities performed directly for or on behalf of a retailer, and clarifies that new section 6203, subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state services that enable the out-of-state retailer to create or maintain an in-state market;
- Revising staff's suggested amendments incorporating the affiliate nexus provisions of new section 6203, subdivision (c)(5), into Regulation 1684 in order to: (A) define the phrase "person or persons in this state" so that it only refers to an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California; (B) clarify that creating a sales and use tax collection obligation based on the presence of an in-state person who refers customers must be limited to those in-state persons who are performing activities to establish or maintain a California market; (C) clarify the phrase "other consideration"; (D) explain what the phrases "directly or indirectly," "indirectly solicit," "indirect solicitation," and "or otherwise" mean with examples; (E) clarify whether a static link that is labeled "click here" constitutes a solicitation; and (F) explain that the method of compensation should not convert an otherwise permissible advertisement into a market-making activity that leads to nexus;
- Revising staff's suggested amendments creating a means by which a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203, subdivisions (c)(5), by utilizing contractual terms and factual certifications so that: (A) the contractual terms do not prohibit an advertising agreement from providing for the payment of commissions based upon completed "click-through" sales; and (B) retailers are excused from obtaining certificates where it would be impossible to do so, for example, where the in-state person is deceased; and
- Deleting staff's suggested amendments to Regulation 1684's website provisions because the amendments may violate the Internet Tax Freedom Act (ITFA), and deleting staff's suggested amendments adding subdivision (b)(2) to Regulation 1684 because the rebuttable presumption in subdivision (b)(2) may be inconsistent with the United States Supreme Court's view of the Commerce Clause.

In addition, staff received a written comment, which noted that Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner published statements of intent in the September 9, 2011, Assembly Daily Journal to memorialize their understanding that the provisions of section 6203, subdivision (c)(5)(A)-(C), were intended to:

> [D]raw a clear line between activities that are "mere advertising" versus more sufficiently meaningful in-state activity that should properly be characterized as "soliciting business" for purposes of meeting the definition of a "retailer engaged in business in this state." Given the evolving nature of online advertising, and the anonymous manner in which it may be delivered to online customers, it is important to note that, in isolation, online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites, and similar online advertising services should not be considered a "referral" under subparagraph (5)(A), nor "direct or indirect solicitation specifically targeted at potential customers in the state" under subparagraph (5)(C). Those types of advertising services are generated as a result of generic algorithmic functions and are anonymous and passive in nature and thus do not rise to the level of referring or soliciting business. Agreements for such advertising services are not covered, unless the person entering the agreement also engages in other activities on behalf of the retailer in this state – such as sending flyers or making phone calls – that are specifically targeted at customers in this state.

The written comment also recommended revising staff's suggesteded amendments incorporating the affiliate nexus provisions of new section 6203, subdivision (c)(5), into Regulation 1684 so that the amendments further provide that the terms "solicit" and "solicitation" do not include "online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services."

Board staff agreed to revise its suggested amendments adding subdivision (c)(2) to Regulation 1684 to define the phrase "in cooperation with" and clarify that subdivision (c)(2) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property because the United States Supreme Court and the California Court of Appeal have held that these types of in-state services establish a substantial nexus in *Tyler Pipe* and *Borders Online*, respectively. Therefore, staff added a new paragraph (c)(2)(B)(i) to its suggested amendments to Regulation 1684 to provide that "services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property." Staff also added new paragraph (c)(2)(B)(ii) to its suggested amendments to Regulation 1684 to define "in cooperation with" in accordance with the general definition of the term, which is that "cooperation" is "an act or instance of working or acting together for a common purpose or benefit." (Dictionary.com.)

Board staff also generally agreed that the phrase "other consideration" should be further clarified. Therefore, Board staff revised its suggested amendments incorporating the affiliate nexus provisions into Regulation 1684 so that they further explain that the consideration referred to in section 6203, subdivision (c)(5), as added by AB 155, is any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise."

Further, Board staff generally agreed that the method of compensation should not convert an otherwise permissible advertisement into a market-making activity that establishes a substantial nexus. Therefore, Board staff revised its suggested amendments explaining how a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus so that the amendments do not prohibit an agreement from providing for the payment of commissions.

Moreover, Board staff generally agreed that retailers should be excused from obtaining certificates to establish that their in-state affiliates did not perform prohibited solicitation activities in California under appropriate circumstances, including where the person required to make the certification is deceased. Therefore, Board staff revised its suggested amendments so that the amendments excuse retailers from having to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

Additionally, after reviewing the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal in detail and interpreting the amendments made to section 6203 by AB 155 in light of the statements of intent, staff concluded that:

- Based on the language in subdivision (c)(5)(B) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer purchases advertisements from a person in this state to be delivered on television, radio, in print, on the Internet, or by any other medium when the advertisement revenue paid to the person *is not based* on commissions or other consideration that is based upon completed sales of tangible personal property. However, the affiliate nexus provisions of new subdivision (c)(5)(A) *do apply* to such agreements when the advertisement revenue paid *is based* on commissions or other consideration that is based upon completed sales of tangible personal property.

- Based on the language in subdivision (c)(5)(C) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer engages a person in this state to place an advertisement on an Internet website operated by that person, or operated by another person in this state, if the person entering into the agreement with the retailer *does not* directly or indirectly

solicit potential customers in this state through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state. However, the affiliate nexus provisions of subdivision (c)(5)(A) *do apply* to such agreements when the person directly or indirectly *does* solicit potential customers in California through such means.

- The Senator and Assembly Members intended for the new provisions of section 6203, subdivision (c)(5)(A)-(C) "to draw a clear line between activities that are 'mere advertising' versus more sufficiently meaningful in-state activity that should properly be characterized as 'soliciting business' for purposes of meeting the definition of a 'retailer engaged in business in this state.'"

- The Senator and Assembly Members did not intend for section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions to apply to an agreement under which a retailer purchases online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as anonymous and passive ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services. In short, the Senator and Assembly members have implicitly presumed that persons who enter into this type of agreement with a retailer generally do not directly or indirectly solicit potential customers for the retailer in California.

In other words, staff concluded that the Legislature intended to create a distinction between "traditional" advertising contracts (i.e., contracts for the sale of advertising space or time with no presumed solicitation) and potentially "nexus-producing" contracts that are not limited to the sale or purchase of traditional advertising (i.e., commission-based contracts with presumed solicitation). Staff also concluded that the Senator and Assembly members believed that anonymous and passive online advertising should be viewed as traditional advertising so that out-of-state retailers will not be required to register with the Board to collect use tax solely because they purchase anonymous and passive online advertising. Therefore, staff generally agreed that staff's suggested amendments to Regulation 1684 should clarify that: (1) the term "advertisement" includes anonymous and passive online advertising, such as anonymous and passive ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites, and similar online advertising; and (2) the terms "solicit," "solicitation," "refer," and "referral" do not include the same types of anonymous and passive online advertising.

However, Board staff did not agree with all of the interested parties comments. Board staff concluded that the proper administration of the amendments made to section 6203, subdivision (c), by AB 155, requires that the Board establish a presumption that a retailer is engaged in business in California if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier, the United States mail, or interstate telecommunication (i.e., a presumption that a retailer is "engaged in business in

California" if the retailer has any in-state physical presence). Retailers can rebut this presumption by establishing that their physical presence in California is so slight that it cannot create a substantial nexus within the meaning of the Commerce Clause. Furthermore, Board staff concluded that the rebuttable presumption set forth in staff's suggested amendments adding subdivision (b)(2) to Regulation 1684 is consistent with the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*) because the presumption only applies when a retailer has a physical presence in California and the presumption that the physical presence creates a substantial nexus and corresponding use tax collection obligation can be rebutted if the retailer can show that its physical presence is so slight that it will not satisfy the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*). Therefore, staff did not delete the rebuttable presumption from its suggested amendments adding subdivision (b)(2) to Regulation 1684.

Board staff did not agree that the phrase "person or persons in this state" needs to be defined so that it only refers to "an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California." The term "person" is broadly defined by section 6005 and the recommended definition is inconsistent with that section. Furthermore, an individual does not need to be a resident of California and a legal entity does not need to be headquartered or domiciled in California in order to perform services in this state.

Board staff did not agree to define the terms "directly," "indirectly," and "otherwise" because these are all broad terms with generally applicable meanings. However, Board staff indicated that it was open to further discussion regarding adding examples to Regulation 1684 that would help clarify the meaning of these terms.

Furthermore, Board staff found that ITFA, as renewed in 2007, imposes a moratorium on the states' imposition of two categories of taxes during the period beginning November 1, 2003, and ending November 1, 2014:

- Taxes on internet access, which means taxes imposed on a service that enable users to connect to the Internet to access content, information, or other services offered over the Internet, whether imposed on the provider or the consumer; and
- Multiple or discriminatory taxes on electronic commerce. (ITFA §§ 1101(a), 1105(5).)

ITFA provides that the term "tax" includes "the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity." (ITFA § 1105(8).) ITFA provides that "[t]he term 'multiple tax' means any tax that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions." However, the term "multiple tax" does "not include a sales or use tax imposed by a State and 1 or more political subdivisions thereof on the same electronic

commerce or a tax on persons engaged in electronic commerce which also may have been subject to a sales or use tax thereon." (ITFA § 1105(6)(A) & (B).) ITFA further provides that "The term 'discriminatory tax' means –

> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that – (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period; (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means; (iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or
>
> (B) any tax imposed by a State or political subdivision thereof, if – (i) the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or (ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of – (I) the display of a remote seller's information or content on the out-of-State computer server of a provider of Internet access service or online services; or (II) the processing of orders through the out-of-State computer server of a provider of Internet access service or online services. (ITFA § 1105(2).)

ITFA also provides that except as expressly provided, "nothing in this title shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act." (ITFA § 1101(b).)

Therefore, Board staff did not agree that its suggested amendments to Regulation 1684's website provisions violate ITFA. This is because the amendments cannot reasonably be interpreted to impose taxes on Internet access, or multiple or discriminatory taxes within the above ITFA definitions. Board staff also concluded that the suggested amendments merely recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state. Further, Board staff concluded that the suggested amendments do not discriminate against Internet access

providers or electronic commerce retailers because whatever use tax collection obligation may be imposed as a result of the amendments:

- Is generally imposed and legally collectible by California, at the same rate, on transactions involving similar property and goods accomplished through other means involving the presence of a retailer's property in this state; and
- Will not be imposed on a different person or entity than in the case of transactions involving similar property and goods accomplished through other means.

In addition, Board staff concluded that the suggested amendments will not require a retailer to collect California use tax solely because California consumers can access the retailer's "out-of-State computer server" via the Internet or deem a provider of Internet access service or online services to be the agent of a retailer for determining the retailer's use tax collection obligation solely as a result of the display of the retailer's information or content on "the out-of-State computer server of a provider of Internet access service or online services" or the processing of orders through "the out-of-State computer server of a provider of Internet access service or online services."

Subsequent Interested Parties Meetings
Board staff conducted additional meetings with interested parties on December 20, 2011, in Sacramento, California, and December 22, 2011, in Culver City, California, to further discuss the comments and responses summarized above, and staff's revisions to its original suggested amendments to Regulation 1684. After the additional interested parties meetings, the interested parties recommended that Board staff:

1. Delete the rebuttable presumption from the suggested amendments adding subdivision (b)(2) to Regulation 1684 or replace the reference to "physical connection" with a reference to "physical presence" in the suggested amendments in order to make the rebuttable presumption more consistent with the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*).
2. Further clarify when a person or persons are "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155, and clarify that subdivision (c)(5)(A) only applies to a retailer when there is a person who is conducting referral "activities in California" that help the retailer establish or maintain a California market.
3. Include examples in the suggested amendments to Regulation 1684 to clarify whether the in-state activities described therein will or will not constitute the "indirect solicitation" of California customers within the meaning of section 6203, subdivision (c)(5)(C), as added by AB 155.
4. Consider adding "unless the computer server located in California is owned or leased by the out-of-state retailer" to the end of the first sentence in Regulation 1684's current provisions regarding webpages and Internet services providers, instead of staff's suggested amendments revising the same sentence so that it begins with the phrase "The use of an unrelated third party's computer server . . . ."

Board staff agreed that the suggested amendments adding subdivision (b)(2) to Regulation 1684 would be more clear if the term "physical connection" was replaced with the term "physical presence" from the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*). In addition, Board staff concluded that it would be helpful if subdivision (b)(2) to Regulation 1684 explained how a retailer with a "physical presence" in California can rebut the presumption that it has a "substantial nexus" with and therefore is engaged in business in California (i.e., by establishing that its physical presence in California is so slight that a finding of substantial nexus would not be constitutionally permissible). Board staff also concluded that it would be helpful to add an additional subdivision (b)(3) to Regulation 1684 to further clarify that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California. Therefore, Board staff revised its suggested amendments adding subdivision (b) to Regulation 1684, accordingly.

Board staff further agreed that it would be helpful if the suggested amendments to Regulation 1684 clarified when a person is "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155. In addition, Board staff concluded that it would be helpful if Regulation 1684 further clarified that subdivision (c)(3), as suggested to be added to Regulation 1684, only applies to a retailer when an individual solicits potential customers under the retailer's agreement while the individual is physically present within the boundaries of California, and that such additional clarification would help ensure that subdivision (c)(3) is interpreted and administered consistently with *Tyler Pipe* and *Borders Online*. Therefore, Board staff suggested adding a new subdivision (c)(5) to Regulations 1684 to further clarify when an individual is in this state within the meaning of section 6203, subdivision (c)(5)(A), and adding a new subdivision (c)(6) to Regulation 1684 to clarify when subdivision (c)(3) of Regulation 1684 applies. Board staff also suggested adding new subdivision (c)(8)(B) and (C) to Regulation 1684 to define the term "individual" as referring to a "natural person" and define the term "person" by reference to the definition in section 6005.

Additionally, Board staff agreed that it would be helpful to add examples to Regulation 1684 to illustrate the application of subdivision (c)(3), as suggested to be added to Regulation 1684, and provide examples of "direct and indirect" solicitation within the meaning of subdivision (c)(3). Therefore, Board staff suggested adding subdivision (c)(9) to Regulation 1684 to provide examples that staff believes will be helpful to illustrate when the "direct and indirect" solicitation activities are present that are necessary to create "affiliate nexus" under subdivision (c)(3).

Finally, staff agreed with the alternative amendments to the first sentence in Regulation 1684's current provisions regarding webpages and Internet service providers and staff incorporated the alternative amendments into its suggested amendments to Regulation 1684. Staff concluded that the alternative amendments achieve staff's intended purpose,

which was to amend the provisions regarding webpages and Internet service providers to recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state.

Proposed Amendments

At the conclusion of the interested parties process, Board staff prepared Formal Issue Paper 12-003, which raised the issue of whether the Board should amend Regulation 1684 to implement, interpret, and make specific the amendments made to section 6203 by section 3 of AB 155 (the problem to be addressed for purposes of Government Code section 11346.2, subdivision (b)(1)), summarized the interested parties process discussed above, and recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to

any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise," similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;

- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor;
- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident; and expressly excuse retailers from obtaining a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting, and making the definitions for the terms "advertisement," "solicit," "solicitation," "refer" and "referral" consistent with staff's understanding of section 6203, subdivision (c)(5), and Senator Hancock's and Assembly Members Blumenfield's, Calderon's, and Skinner's intent;
- Define the term "person" by reference to the definition of "person" set forth in section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);

- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize and provide notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Formal Issue Paper 12-003 also contained staff's recommendations that the Board:

- Retain the other current provisions of Regulation 1684 regarding Internet service providers, online service providers, internetwork communication service providers, other Internet access service providers, and World Wide Web hosting services based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 12-003 during its February 28, 2012, Business Taxes Committee meeting, and the Board voted to propose the adoption of staff's recommended amendments because the Board determined that the amendments are reasonably necessary for the specific purposes of:

- Making Regulation 1684 consistent with the amendments made to section 6203 by AB 155;
- Providing notice to retailers that California will be a "substantial nexus state" (impose the obligation to collect California use tax to the fullest extent permitted by the Commerce Clause) and that a retailer with a physical presence in California will be required to register to collect California use tax, unless the retailer can show that its physical presence is so slight that the Commerce Clause will not permit California to impose a use tax collection obligation on the retailer or the retailer is otherwise exempt from registering to collect use tax, when the amendments made to section 6203 by AB 155 are operative;
- Incorporating the new commonly controlled group nexus provisions added to section 6203, subdivision (c)(4), by AB 155, defining the phrase "in cooperation with" as used in subdivision (c)(4), and clarifying that subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property;
- Incorporating the new affiliate nexus provisions added to section 6203, subdivision (c)(5), by AB 155; clarifying the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales

of tangible personal property," as used in section 6203, subdivision (c)(5); clarifying that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5) shall be made at the end of each calendar quarter; clarifying that, for purposes of section 6203, subdivision (c)(5), an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf; clarifying that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California; creating a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications; defining the terms "advertisement," "individual," "person," "solicit," and "solicitation" for purposes of applying section 6203, subdivision (c)(5); and providing examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);

- Recognizing and providing notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Providing that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

The proposed amendments are anticipated to provide the following benefits:

1. Ensure that Regulation 1684 is consistent with the provisions of new section 6203, when new section 6203 becomes operative;
2. Give needed guidance to retailers as to whether their activities create a "substantial nexus" with California and will require them to register with the Board to collect use tax when new section 6203 becomes operative;
3. Ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Tyler Pipe*, *Scripto*, *National Geographic Society*, *Current*, and *Borders Online*; ans
4. Ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently.

The proposed amendments to Regulation 1684 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1684.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 12-003, all but one of the exhibits to the formal issue paper, and the comments made during the Board's discussion of the formal issue paper during its February 28, 2012, Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1684 described above. During the committee meeting, Betty T. Yee, Board Member for the Board's First Equalization District and Business Taxes Committee Chairwoman, acknowledged Senator Hancock's and Assembly Members Blumenfield's, Calderon's, and Skinner's statements of intent published in the September 9, 2011, Assembly Daily Journal, and included in exhibit 3 to Formal Issue Paper 12-003. However, Ms. Yee noted that the statements were letters expressing the Senator's and Assembly Members' personal intent, not binding statements of the entire Legislature's intent included in operative provisions of AB 155, and that, regardless of the statements, technology is changing and the Board has the discretion to revisit the issue of whether online advertising may constitute soliciting within the meaning of section 6203 if technology changes so that future online advertising is not necessarily the result of algorithmic functions that are anonymous and passive in nature. Furthermore, the Board voted to clarify in the rulemaking record that the statements of intent are not supporting documents (authority or reference) for the proposed amendments.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1684 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1684 that would lessen any adverse impact the proposed action may have on small business or that would be lessen burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

Sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers.

Also, section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203.

Regulation 1684 currently requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board. Regulation 1684 does not currently regulate the health and welfare of California residents, worker safety, or the state's environment.

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and the amendments made by AB 155 will become operative on either September 15, 2012, or January 1, 2013. New subdivision (c) will provide that the term "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty" and provide that retailers with substantial nexus, include, but are not limited to, retailers with commonly controlled group nexus and affiliate nexus (as discussed in detail above). Therefore, any retailer that has a "substantial nexus" with California, including a retailer with commonly controlled group nexus or affiliate nexus, will be required to register with the Board to collect California use tax when the amendments made to section 6203 by AB 155 become operative, regardless of whether the Board adopts the proposed amendments.

The proposed amendments to Regulation 1684 will help retailers better understand whether they are obligated to register to collect California use tax when the amendments made to section 6203 by AB 155 become operative by:

- Making Regulation 1684 consistent with the amendments made to section 6203 by AB 155;
- Providing notice to retailers that California will be a "substantial nexus state" and that a retailer with a physical presence in California will be required to register to collect California use tax, unless the retailer can show that its physical presence is so slight that the Commerce Clause will not permit California to impose a use tax collection obligation on the retailer or the retailer is otherwise exempt from registering to collect use tax, when the amendments made to section 6203 by AB 155 are operative;
- Incorporating the new commonly controlled group nexus provisions added to section 6203, subdivision (c)(4), by AB 155, defining the phrase "in cooperation with" as used in subdivision (c)(4), and clarifying that subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property;
- Incorporating the new affiliate nexus provisions added to section 6203, subdivision (c)(5), by AB 155; clarifying the phrases "commission or other

consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5); clarifying that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5) shall be made at the end of each calendar quarter; clarifying that, for purposes of section 6203, subdivision (c)(5), an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf; clarifying that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California; creating a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications; defining the terms "advertisement," "individual," "person," "solicit," and "solicitation" for purposes of applying section 6203, subdivision (c)(5); and providing examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5); and

- Providing notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state. (As discussed in detail above.)

Furthermore, the proposed amendments to Regulation 1684 are consistent with section 6203, as amended by AB 155, the proposed amendments will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect, and the proposed amendments will not impose any new taxes or expand any retailer's use tax collection obligation beyond that imposed by new section 6203 when the amendments made to section 6203 by AB 155 become operative (as discussed in detail above). Therefore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. The Board has also determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

In addition, the forgoing information provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant adverse economic impact on business.

The proposed amendments may affect small business.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1684

Section 1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances~~this state is a "retailer engaged in business in this state" and~~ the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee); or~~.~~

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a

person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and

links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by a~~n out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a

substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(3~~b~~) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(A~~1~~) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(B~~2~~) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~f~~d) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~g~~e) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~h~~f) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1684

Title: 1684, *Collection of Use Tax by Retailers*

Preparation: Brad Heller
Legal Contact: Brad Heller

Board proposes to amend Regulation 1684, *Collection of Use Tax by Retailers*, to interpret the amendments made to RTC section 6203 by AB 155 (Stats. 2011, ch. 313) regarding the definition of "retailer engaged in business in this state."

History of Proposed Regulation:

May 30-31, 2012	Public Hearing
April 6, 2012	OAL publication date; 45-day public comment period begins; Interested Parties mailing
March 27, 2012	Notice to OAL
February 28, 2012	Business Tax Committee, Board Authorized Publication (Vote 4-0)

Sponsor:	NA
Support:	NA
Oppose:	NA

Statement of Compliance

The State Board of Equalization, in process of adopting Special Taxes Regulation 1684, *Collection of Use Tax by Retailers*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on April 6, 2012, 54 days prior to the public hearing.

May 2, 2012

Richard Bennion
Regulations Coordinator
State Board of Equalization

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May 29, 2012

The Honorable Jerome Horton
Chair, State Board of Equalization
450 N. St.
Sacramento, CA 94279-0080

Re: Public Notice dated April 6, 2012 of Proposed Amendments
To Regulation 1684: **Suggestions to Expand Proposed Amendments.**

Dear Mr. Horton,

First I want to compliment the Board Members for the timeliness and general scope of the above notice which is to be considered by the Board at the Meetings of May 30-31, 2012. Hopefully, the proposed amendments can be implemented in time to produce substantial additional use tax revenue that could begin to flow in fiscal 2012-2013 should Stats. 2011, chapter 313 (AB 155) become effective on September 15, 2012, as currently seems possible, if not likely.

I suggest, respectfully, that Members consider expanding the rebuttable presumption in proposed Regulation 1684 (b) to recognize that all, or at least most, large remote retailers selling to California purchasers via the internet, catalogs, or telephonically do so via "sales on approval" under which, in accordance with present regulation 1628 (b) (3) (D), they continue to own the goods being sold until after their delivery to and acceptance by California purchasers. Thus, at least such large remote retailers should be considered to have substantial physical presence and "substantial nexus" within the state of California and therefore be liable to collect and remit use tax from their purchasers in accordance with RTC § 6203, as amended by AB 155.

In support of this suggestion, I am attaching the following documents:

1. A Memorandum of Points and Authorities filed on behalf of the State Board of Equalization by the California Attorney General in Direct Marketing Association, Inc. v. Wlliam M. Bennett, et al., No. CIVS 88-1067 MLS EM (U. S. Dist. Ct., E.D.Cal., filed June 14, 1991.

2. Order Granting Plaintiff's Motion for Summary Judgment in Direct Marketing Association, Inc. v. William M. Bennett, et al., supra, dated July 12, 1991.

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3. Reporter's Transcript of hearing of June 28, 1991 before Judge Milton L. Schwartz in Direct Marketing Association, Inc. v. William M. Bennett, et al., supra.

4. Letter to Albin Koch from Susan Russell dated May 29, 2007.

5. Report dated July 15, 2007 from Professor Patrick A. Scholten, Ph.d. on internet sales operations.

6. Sample sales terms from a large internet retailer.

One possible approach to implementing this suggestion could be to:

Insert the following sentence at the end of proposed Regulation 1684 (b) (3):

"A retailer will be regarded as having a physical presence in California if it makes substantial sales to California purchasers that constitute 'sales on approval' within the meaning of existing Regulation 1628 (b) (3) (C)."

I appreciate the staff work and expertise reflected in the proposed revisions to Regulation 1684, and hope that this suggestion may be found useful in implementing AB 155 as promptly and productively as possible.

Yours very truly,

Albin C. Koch

CC: The Honorable John Chiang, State Controller
The Honorable Betty T. Yee, Member, State Board of Equalization
The Honorable Senator George Runner, Member State Board of Equalization
The Honorable Michelle Steel, Member State Board of Equalization

Ms. Marcy Mandel, Deputy Controller
Diane G. Olson, Chief, Board Proceedings Division

Enclosures: As listed above.

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JUN 14 1991

CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA
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MLS

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

DIRECT MARKETING ASSOCIATION, INC., Plaintiff, v. WILLIAM M. BENNETT, et al., Defendants.	No. CIVS 88-1067 MLS EM DEFENDANTS' MEMORANDUM OF POINTS & AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN FAVOR OF SUMMARY JUDGMENT FOR DEFENDANTS

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UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

DIRECT MARKETING ASSOCIATION, INC., Plaintiff, v. WILLIAM M. BENNETT, et al, Defendants.	No. CIVS 88-1067 MLS EM DEFENDANTS' MEMORANDUM OF POINTS & AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN FAVOR OF SUMMARY JUDGMENT FOR DEFENDANTS

I

BRIEF SUMMARY

DIRECT MARKETERS CAN CONSTITUTIONALLY BE REQUIRED TO COLLECT CALIFORNIA'S USE TAXES

Unquestionably the activities of plaintiff's members, Direct Marketers, come within the requirements of section 6203(f), California Revenue and Taxation Code.[1] Direct Marketers engage in substantial and recurring solicitations of and sales to California customers, benefit from the financing and debt collection of California financial institutions which issued the credit cards used to effectuate a great percentage of such sales, and have property in this state. The only issue before this Court is

1. Unless otherwise specified, all statutory references are to the California Revenue and Taxation Code.

whether Direct Marketers can constitutionally be required to collect and remit the California use taxes, which are due from their California customers.

In State v. Quill Corp., ___ N.W.2d ___ (N.D. 1991),[2] the North Dakota Supreme Court, relying on Complete Auto Transit, Inc. v. Brady, 430, U.S. 274 (1977), held that Quill, a mail-order retailer, can constitutionally be required, pursuant to a statute similar to section 6203, to collect and remit North Dakota's use taxes. Rejecting Quill's reliance upon National Bellas Hess, Inc. v. Illinois Rev. Dept., 386 U.S. 753 (1967),[3] the court observed:

> "The economic, social, and commercial landscape upon which Bellas Hess was premised no longer exists, save perhaps in the fertile imaginations of attorneys representing mail order interests. In the quarter-century which has passed in the interim, 'mail order' has grown from a relatively inconsequential market niche into a goliath now more accurately delineated as 'direct marketing.' The burgeoning technological advances of the 1970's and 1980's have created revolutionary communications abilities and marketing methods which were undreamed of in 1967."[4]

The dynamics of the direct marketing industry reflected in the stipulated facts herein bear little resemblance to the 1967 (and/or prior) activities of National Bellas Hess, Inc. The reference by the Supreme Court in National Bellas Hess (id. 759-60) to 2,300 taxing jurisdictions which could entangle a Direct Marketer in "virtual welter of complicated obligations to local jurisdictions", is inapplicable to this case. California imposes only a single, uniform statewide use tax rate.[5] Section 6203(f) meets the criteria set forth in Complete Auto, supra, a decision in which the Supreme Court rejected previous holdings, (such as National Bellas Hess), to the effect that "exclusively" interstate commerce cannot be subject to state taxation, and promulgated the present standard to evaluate state taxation which is claimed to violate the commerce and due process clauses. To the extent that the precedent of National Bellas Hess, retains any validity, that holding is inapplicable to the facts of this case.[6] As a matter of law, the defendants are entitled to summary judgment.[7]

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2. A copy of the memorandum opinion accompanies this memorandum in the Appendix.

3. Similarly, notwithstanding the length of, and authorities cited in, plaintiff's revised memorandum, plaintiff effectively rests its entire case on the holding of National Bellas Hess.

4. Assuming arguendo, as plaintiff argues, that the rejection of National Bellas Hess in Quill is dicta, the reasoned analysis of that court is what defendants cite to this Court.

5. Section 6203(j).

6. Plaintiff's citation (rev. mem., pp. 11 & 13) as support for the argument that National Bellas

(continued...)

II

MATERIAL FACTS

The defendants submit that all the stipulated facts and the affidavits of James Caldwell (filed March 27, 1991) and John Gibbs should be considered by the court. To the extent plaintiff implies (page 2, rev. mem.) that the "entire" factual record in this case is limited to the stipulated facts and the admitted allegations of plaintiff's complaint, the same is incorrect. The parties agreed, subject to the same "admission of relevancy" disclaimer contained within the stipulated facts, that the defendants could direct the court's attention to, and argue from, the facts set forth in the affidavits of James Caldwell and John Gibbs (being filed with this memorandum).

III

THE "GOLIATH" OF DIRECT MARKETING WAS NOT THE BUSINESS BEFORE THE SUPREME COURT IN 1967

The mail order company in National Bellas Hess utilized twice-a-year catalog mailings

6. (...continued)
Hess is the reason for the State's loss in the two pending (now on appeal) state section 6203(f) refund actions involving Lands' End, Inc, and Sturbridge Yankee Workshop, is extraordinary. Plaintiff obviously cites the cases as "rejection" by other courts of the State Board of Equalization's ("SBE") "nexus" position concerning section 6203(f). In an effort to provide a factual record to this Court with respect to the magnitude, and particulars of the sales and solicitations, by the mail order industry, of California customers, defendants proposed submitting to this Court the stipulated facts filed in both cases, because plaintiff is only a trade association without access to the sales and solicitation figures of its members. The defendants believe such facts would reflect the spectrum of the activities of mail order companies from the relatively modest (although above the registration criteria employed by SBE) activities of Sturbridge to the substantial activities of Lands' End. Plaintiff stated it would not agree to the submission of the stipulated facts from these cases because the same were not part of any "reported decision" but rather filings with trial courts whose decisions are without precedential effect. The Sturbridge facts were filed under seal. The Lands' End facts were filed under seal and then its counsel produced a "public" version. The defendants will provide copies of these stipulated facts to this Court upon order, if the Court believes that same would be helpful, and submit that plaintiff is now estopped from asserting that trial court decisions and underlying facts may not be considered because the same only involve "filings" made to a trial court. In addition, since plaintiff believes that state trial court decisions are worthy of citation to this court, in the appendix which accompanies this memorandum are copies of two 1991 Tennessee opinions wherein the particular mail order retailers' use tax collection challenges were overruled. (Bloomingdale's By Mail, Ltd. v. Huddleston, No. 89-3017-II (12th Dist., Tenn. 1991) and SFA Folio Collections, Inc. v. Huddleston, No. 89-3015-III (20th Dist., Tenn. 1991)).

7. Summary judgment may be rendered in favor of the opposing party even if that party has made no cross motion. Cool Fuel, Inc. v. Connett, 685 F.2d 309, 311 (9th Cir. 1982). See also Nevada VTN v. General Insurance Company of America, 834 F.2d 770, 777 (9th Cir. 1987). Also see, Wright & Miller, Federal Practice and Procedure § 2720 n. 20.

supplemented by occasional advertising "flyers" and mail/or common carrier contacts which resulted in an unspecified amount of sales in Illinois. (386 U.S., 754-55)[8] As the court noted in Quill, supra, [9] the "facts" of direct marketing (the mail order industry), including the extent of business, and methods of doing business, so exceed anything considered by the court in National Bellas Hess [10] so as to render factually inapplicable to the modern mail order industry the doctrine of that case upon which plaintiff herein relies.

In 1967 when National Bellas Hess was decided, national mail order sales were thought to be between $2.4 billion (Id. at 763, Fortas, J., dissenting) and approximately $13 billion. [11] National mail order sales are now estimated to be at least $183 billion and to account for fifteen percent (15%) of total national sales. [12] In 1990, the mail order industry is estimated to have mailed 13.6 billion catalogs to national consumers with:

> "computerized database marketing allowing mailings directed to specific demographical groups. In fact, the sale and rental of lists of names of prior or potential mail order purchasers has itself become a three-billion-dollar business. Technology has also changed the method of receiving orders, with the increased efficiency of toll-free telephone lines, fax orders, and direct computer ordering replacing the less-immediate "mail" order, and advances in the parcel delivery industry allow a wide variety of options, including overnight delivery." (Quill, at pp. 10-11)

The acceptance of credit cards, more fully discussed, infra, is among the most important methods through which Direct Marketers now conduct business, a means of accomplishing sales not mentioned or even intimated by the Supreme Court in National Bellas Hess.

The exact business (solicitation and sales figures) of any individual Direct Marketer is not before this Court. This Court decided that plaintiff, as opposed to an individual Direct Marketer, has standing to raise a constitutional challenge to California's legislative and administrative efforts to secure

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8. The dissent mentions sales figures (Id. at 760-61) but the same were not mentioned by the Supreme Court in its decision.

9. See also the memorandums of decision from the two Tennessee trial court cases appended hereto.

10. Or considered by the dissent. (Id. at 760-66)

11. See Hartman, "Collection of the Use Tax on Out-Of-State Mail Order Sales," (May 1986) 39 Vanderbilt Law Review 993, 1006 ("Hartman"). A copy of this article is contained in the Appendix.

12. Quill, at 11, and Hartman, supra, at 1008.

use tax collection by Direct Marketers. Plaintiff is not informed of the "figures-numbers" of its members solicitation and sales activities. However, Direct Marketers do engage in substantial and recurring solicitations of and sales to California customers. (Stip. para. 16.)

Nevertheless, utilizing the undisputed facts, the information contained the in the affidavits of James Caldwell and John Gibbs, and the relevant cases and authorities, the enormous magnitude of Direct Marketers' California activities can reasonably be discerned.

California has the largest (28,314,000)[13] population of any of the states, with a corresponding state budget (and budget deficit), and it is sometimes said that California's economy exceeds that of all countries but the world's largest industrial powers. [14]For example, in fiscal 1989-90, SBE collected in excess of $17,250,000,000 in sales and use taxes, (not including the "earthquake tax" or special district taxes) [15] which roughly translates (using the applicable six percent (6%) tax rate) to annual sales of $286,350,000,000 for which such taxes were collected. Even assuming that the fifteen percent (15%) of "total sales nationally" noted by the court in Quill is limited to retail sales of tangible personal property or is not exactly the "California" norm, the total volume of mail order sales in California is obviously in the tens of billions of dollars. If the sales by Direct Marketers in this state were as low as one percent (1%) of the 1989-90 sales for which sales and use taxes were collected, the annual amount would exceed $2,800,000,000.[16]

When the California economy (in terms of taxable sales) is considered in the context of the solicitation and sales figures of mail order companies with respect to states with much smaller populations (figures taken from recent "use tax" decisions) the magnitude of what is being accomplished

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13. California's state gross product (this State's share of GNP exceeds 12 percent (12%) of GNP.

14. All the population and economic figures set forth in this and the following paragraphs are taken from the "Statistical abstract of the United States," U. S. Department of Commerce, (1990) and are for 1988.

15. See SBE's 1989-90 Annual Report (issued January 7, 1991), at pp. 13 & A-23.

16. Unquestionably, the 1989-90 sales and use taxes collected by SBE include remittances by mail order entities which have, for whatever reason, registered with SBE and collected California's use tax and which might not benefit from a judgment in plaintiff's favor. It may be correct to assume that the volume of business by the mail order industry in California includes entities which are not Direct Marketers.

in California by Direct Marketers becomes readily apparent.

In North Dakota, with a population of 667,000, Quill makes annual sales of just under $1,000,000, to approximately 3,500 customers, while mailing into that state 230,000 separate catalogs and flyers. By comparison, Quill's overall annual sales exceed $200,000,000. (Quill, at 29) Thus, Quill's North Dakota sales are less than one-half of one percent (0.5%) of total sales. Using the same ratios of sales, customers and mail solicitations, if Quill's California sales (or that of a corresponding Direct Marketer) were as low as five percent (5%) of national sales, the number of catalogs and flyers mailed into the state would exceed 2,000,000, the number of customers would exceed 35,000, and sales would equal $10,000,000.

In 1987, SFA Folio Collections (a mail order retailer involved in litigation with many states) mailed 733,000 catalogs to Connecticut residents. SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 671 (fn. 5) (Conn. 1991). Connecticut's population of 3,233,000, is less than twelve percent (12%) of California's.

In 1983 and 1984, L.L. Bean (a national leader of the mail order industry)[17] had sales in Pennsylvania of $12.4 million and $12.5 million. L.L. Bean, Inc. v. Commonwealth, 516 A.2d 820, 822 (Pa. 1986). Pennsylvania's population of 12,001,000, is forty-two percent (42%) of California's.

The number of "California" "800" line telephone calls, credit card approvals, financing and debt collection, and product shipments which result from Direct Marketers' California solicitations and sales are, beyond question, correspondingly in the tens of millions. For example, each credit card sale involves a separate approval process. Approval is issued, usually through electronic equipment, by the California financial institution which has set a credit limit for the California customer. Thereafter, the institution, which issued the credit card, bills the customer, and if payment is not "voluntarily" forthcoming, utilizes all proper means of collection. (Stip. para's 18, 20, 33, 39, 40.) Unquestionably, all these activities take place in California.

Finally, every sale includes a separate delivery in California to a California customer. Even assuming a $100 average sale by Direct Marketers, and as little as $200 million in annual sales to California customers, 2,000,000 times each year (over 5,400 times each day) deliveries are made for

17. See Hartman, supra, at 994.

Direct Marketers in California, to a California customer on a California highway (a "benefit" afforded Direct Marketers).

The magnitude of the sales by Direct Marketers in California, relative to all entities which sell tangible personal property at retail in this state, is amply demonstrated by the fact that $500,000 in annual sales places any retailer in the top seven percent (7%) of all permitted retailers.[18] SBE only requires mail order entities with annual sales in excess of $500,000 to register and collect California's use taxes (and only so long as other criteria are met).[19]

IV

REQUIRING DIRECT MARKETERS TO COLLECT AND REMIT CALIFORNIA'S USE TAXES SATISFIES THE COMPLETE AUTO CONSTITUTIONALITY STANDARD FOR STATE TAXATION OF INTERSTATE COMMERCE

A. The "Nexus" Standard

Plaintiff, citing American Oil Co. v. Neill, 380 U.S. 451, 458 (1965), argues that "only where a corporation, pursuant to permission given, enters a state and proceeds to do local business (will) the definite link required by the Constitution . . . be found." (rev. mem. pg. 7.; emphasis added.) Such is not the law.[20] [21]

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18. Gibb's affidavit, page 3.

19. The additional necessary criteria involve: retail sale of tangible personal property which would be subject to sales tax if sold in this state; 300,000 annual mail solicitations involving at least 3 mailings; and, more than 1,000 sales paid by means of credit facilities extended by financial institutions regulated by or located in California. This fourth criteria can be alternatively met by other requirements set forth in the proposed regulation which accompanies the affidavit of James Caldwell. For this case, however, the "credit facilities extended: is the relevant criteria.

20. In American Oil a fuel dealer's predecessor in interest was licensed to do business in Idaho. The predecessor accepted federal government bids in Utah, which had been issued in Seattle, to deliver fuel. The fuel was subsequently delivered to the government outside Idaho at which time title passed. Idaho claimed an ability to levy an excise tax upon the transaction because the fuel dealer knew that the federal government would subsequently transport the fuel into Idaho for use there by a federal government agency. In rejecting the state's claimed ability to levy a tax upon the particular transaction involved, the Supreme Court observed that there must be "some definite link, some minimum connection between a state and the person, property or transaction it (the state) seeks to tax." The Supreme Court observed that while a corporation's business activities pursuant to permission given, in a state permits a strong inference of a "link" between that business entity and the state, transactions dissociated with local business cannot be taxed by that state. (380 U.S. at 452-59; emphasis added.)

21. Similarly, and obviously intentionally misstated by plaintiff (rev. mem. p. 12), is the "nexus" (continued...)

In American Oil, Idaho was levying a tax directly upon the seller; in the present case California is only imposing a duty to collect the use tax from California purchasers/taxpayers. In American Oil the state was not even linked to the transactions by any sale from the taxpayer to any state resident or entity. The Supreme Court in National Geographic Society v. California Board of Equalization, 430 U.S. 551, 560 (1977), specifically distinguishing American Oil, made it clear that the "nexus" contacts which are required to permit imposition of a duty to collect use taxes are not as extensive as those required to permit the imposition of direct taxation upon an entity or person.

In Complete Auto, supra, the Supreme Court rejected previous holdings to the effect that exclusively interstate commerce was immune from state taxation, the doctrine specifically referenced in National Bellas Hess (Id. at 759). Instead the Supreme Court announced a standard by which state taxation in this area is to be tested, a standard which focuses not solely upon whether any entity subject to state tax requirements has a physical presence in that state, but also upon whether the activity sought to be taxed has a substantial "nexus" with the taxing state. The Supreme Court addressed a commerce clause challenge to a Mississippi tax assessed against that company which transported, by truck, new automobiles (assembled outside but rail shipped into Mississippi) from a Mississippi rail station to Mississippi dealers. (430 U.S. at 276) The company claimed the Mississippi transportation was part of interstate movement (and commerce) and, thus, that the taxes assessed were unconstitutional.The

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21. (...continued)
standard of Illinois Commercial Men's Assn. v. Board of Equalization, 34 Cal.3d 839 (1983). The California Supreme Court never made the statement attributed to it by plaintiff (without reference by plaintiff to any page of the decision) but observed, citing National Bellas Hess, that:

> "(t)he United States Supreme Court has considered the circumstances under which a state may, within the limits of the due process clause, impose a tax on a foreign corporation that conducts its business by mail from outside the taxing state. Generally speaking, the taxing state must have a substantial interest in the transactions in order to justify imposition of the tax. This interest is measured by the extent and nature of the contacts between the state and the foreign corporation (such as the presence of agents of the corporation within the state), and the benefits conferred on the corporation by the state." (Id. at ____)

In Scholastic Book Clubs, Inc. v. Board of Equalization, 207 Cal.App.3d 734, 738 (1989) that appellate court employed the above language of the California Supreme Court in addition to noting that (based upon National Bellas Hess, supra, and Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954)) "nexus" is "usually" absent without personal contact although mail is used to conduct business.

In neither case were the activities of Direct Marketers, as stipulated herein, at issue, while in both cases each business had agents working in California.

Supreme Court disagreed and established the following four-prong test for ascertaining if a state tax will withstand commerce clause scrutiny. State taxes are constitutional 1) if applied to an activity with a substantial nexus with the taxing state; 2) if fairly apportioned; 3) if not discriminatory against interstate commerce; and, 4) if fairly related to the services provided by the state. (430 U.S. at 279, 289.)

In Goldberg v. Sweet, 109 S.Ct. 582 (1989), the Supreme Court reaffirmed the Complete Auto test. The Supreme Court upheld the constitutionality of an Illinois telecommunications tax imposed upon both intra- and interstate telephone calls originating or terminating in Illinois, charged to an Illinois service address with credit given if a tax is paid to another state for the same call. Telecommunications retailers are required to collect the tax from consumers who charge calls to their service addresses. (109 S.Ct. at 585-86.) The Supreme Court observed that its decision in Complete Auto Transit "specifically reject(ed) the view that the states cannot tax interstate commerce." (109 S.Ct. at 588.)[22] The Supreme Court noted the parties' agreement that Illinois had substantial nexus with the telecommunications subject to the tax (the first prong); that the tax can be applied only to the in-state component of the activity being taxed (the second prong); found that the tax did not discriminate against interstate commerce (the third prong); and finally, in discussing the fourth test (whether the tax is fairly related to the "taxpayers" activities within the state), the Supreme Court stated that the tax which may be imposed cannot be constitutionally limited to the costs to the state of the particular activity sought to be taxed. "On the contrary, interstate commerce may be required to contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct benefit." (109 S.Ct. at 588-92; emphasis added.)

In California, section 6201 imposes a tax upon the storage, use or consumption of tangible personal property purchased from a retailer when the property will be stored, used or consumed in California. Here the tax is imposed upon California purchases from Direct Marketers. All states,

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22. See also D. H. Holmes v. McNamara (1988) 486 U.S. 24, 30-31, wherein the Court also reaffirmed its ruling from Complete Auto. Plaintiff's claim (rev. mem., p. 9) that in D. H. Holmes the Supreme Court "underscored" National Bellas Hess is specious. The Supreme Court specifically rejected the argument that D. H. Holmes' catalog mailings to Louisiana residents were immune from state taxation on the basis of National Bellas Hess by noting D. H. Holmes' receipt of direct benefits from Louisiana, physical connection to the state and economic presence in the state. (486 U.S. 33-34; emphasis added.) Under all three "nexus" criteria, D. H. Holmes had "nexus." If National Bellas Hess remains the "standard," D. H. Holmes' "economic pressure" in Louisiana would have been irrelevant.

including California, that impose sales taxes also impose a use tax, the constitutionality of which is settled, on purchases from out-of-state to protect sales tax revenue and place in-state retailers on competitive parity with out-of-state retailers exempt from sales tax. (National Geographic, 430 U.S., 555.) There is no double (or prohibited multiple) taxation because section 6406 provides a credit for any sales or use taxes paid, to any jurisdiction, for the same purchase.

In American Trucking Association v. Scheiner (1987) 483 U.S. 266, 282, the Supreme Court explained the discrimination (third prong) issue involving state taxation and the Commerce Clause, as follows: "do the methods by which the . . . taxes are assessed discriminate against some participants in interstate commerce in a way that contradicts the central purpose of the Commerce Clause?"[23] Even if prohibited discrimination with respect to California's use tax scheme were claimed by plaintiff, the Supreme Court observed in National Geographic that "(s)tates necessarily impose the burden of collecting the tax on the out-of-state seller; the impracticality of its collection from the multitude of individual purchasers is obvious." (430 U.S. at 555; citation omitted.)[24]

The fourth prong of the Complete Auto test is the corollary to the first. The activities conducted in the state (the first prong) must be benefitted, even if indirectly, by services provided by the state (the fourth prong). In this case where, pursuant to Complete Auto, there are no concerns with regard to apportionment or discrimination, the requirements of the commerce clause as articulated by the Supreme Court, amount to the due process standard. For both commerce clause and due process purposes, the totality of the Direct Marketers' transactions activities within California is what determines "nexus" and permits imposition of a use tax collection and remittance responsibility.

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23. In connection therewith, the Supreme Court recognized that when the state has used the only practicable means of collecting a tax, and the use of a more finely graduated method would pose genuine administrative burdens, the commerce clause prohibition on discrimination does not require the state to avoid the use of that practicable method. (483 U.S. at 296 & n. 26.)

24. Plaintiff's contention (rev. mem. p. 17, fn. 10) regarding this state making an effort to collect, from California residents, the use tax which Direct Marketers resist collecting, is meritless in view of this observation by the Supreme Court. In fact, if plaintiff actually wants to engage in a war of what the parties have not "shown" (footnote 10, supra) Direct Marketers have not "shown" in this modern computer age, where electronic equipment is utilized for obtaining the issuing institution's approval for every credit card sale, that collecting and remitting California's single rate use tax involves any burden whatsoever. Plaintiff and its members do not want to address technological advances (in court actions) with the states that seek only tax collection for billions of dollars in sales. In court the mail order industry relies on National Bellas Hess and its language discussing 1967 burdens while, in doing business, the industry relies upon any available 1990's technological advance.

B. The Involvement of California Financial Institutions in Credit Card Sales Provides Constitutional "nexus".

Direct Marketers' sales to California customers are clearly transactions (activities) with a California "nexus" (the first prong). Orders are solicited in California through mailings into the state. Orders are taken from California through forms mailed from California and telephone calls placed from California in this state. Orders are delivered in California. Credit card approval and financing for many of these orders is provided by California financial institutions.

Plaintiff's recitation (rev. mem. pp. 3-4) of the undisputed facts, and argument (rev. mem. pp. 9-11) with respect to Direct Marketers' acceptance of VISA and MasterCard credit cards, [25] obviously and intentionally distorts both these credit extension systems and the participation of Direct Marketers in transactions with "nexus" to California.

In Colorado Springs National Bank v. United States, 505 F.2d 1185 (10th Cir. 1974), the Court of Appeals engaged in an extended discussion of the mechanics of credit card transactions.[26] As that court noted, using even the technology and computers available by 1974:

> "[f]or years banks, including . . ., have issued letters of credit. The credit card program furnishes a facility to handle these operations in a simple manner adaptable to operation through modern computers. A letter of credit is 'a letter whereby one person requests some other person to advance money or give credit to a third person, and promises to repay the same to the person making the advancement.' [Citation omitted.] The same function is performed by the handy, plastic card issued by the bank. The participating merchant honors the card in payment for merchandise, the issuing bank pays the merchant, and the card user is liable to the bank.
>
> "Banks, . . ., have for years made loans to merchants on accounts receivable. The credit card system performs the same function more easily. The merchant sends the sales slip to the bank which pays him, or gives him credit, for the amount shown on the slip less a negotiated discount. The only change is in the method. Instead of getting a bank loan on the security of accounts receivable, the merchant receives a discounted payment immediately. Instead of getting loan interest, bank receives the discount.
>
> "Loans for consumer purchases are a recognized part of our economy. Over the years taxpayer, along with other commercial banks, has made many such loans in varying forms. The credit card system simplifies the procedures. The cardholder is charged with the amount of the purchase and, unless he pays the bank within a specified time after the

25. The facts are undisputed that Direct Marketers make over one-half of their sales through acceptance of credit cards and that a significant portion of sales to California customers are charged to VISA and MasterCard credit cards issued by California financial institutions. (Stip. para. __)

26. The legal issue addressed was the deductibility of expenses associated with credit card operation start-up costs.

billing date, he must pay interest or a finance charge. The consumer gets the credit and the bank receives payment for the extension of credit.

"The credit card system takes advantage of modern technology. After a card is used, a key-punched sales slip is placed in a computer which processes and routes the transaction so that the necessary charges and credits will be made." (Id. at 1190; citations omitted.)

The two essential elements of the VISA and MasterCard systems in which Direct Marketers participate are the Direct Marketer and the financial institution which issued the credit card accepted for the purchases. All of the other components of these systems (acquiring banks, processors, call authorization centers, and settlement systems) only facilitate the process through which Direct Marketers: 1) accept these credit cards for purchases, after requesting and receiving the issuing institution's approval authorization; 2) send the transactions to acquiring banks for routing through the systems for proper charges and credits; and, 3) get paid at a discount (which is based upon the fees which must be paid to the issuing institution and the processing costs of the acquiring banks).

Plaintiff would like this Court to believe that credit card purchase approval comes from processors or acquiring banks. However, these entities are solely communicators of the approval which can only be provided by the issuing institution which must maintain 24-hour issuing capability. [27] (Stip. para.'s 18, 19, 20, 31, 32.) Additionally, one obvious reason that customers placing telephone orders provide their telephone numbers to Direct Marketers (Stip. para. 12) is so that these customers can be recontacted in the event a credit card purchase is not approved.

Similarly, while the actual dollar transfer to Direct Marketers for credit card transactions is made through acquiring banks, as the court recognized in Colorado Springs, issuing institutions (not acquiring banks) are the source of payment to Direct Marketers. (505 F.2d at 1190) Direct Marketers request and obtain approval codes, provide this information to acquiring banks, and in doing so (and so long as the code was validly obtained) provide acquiring banks with the only means to require issuing institutions to provide the acquiring banks with credits. (Stip. para. 33) Such credits are the sole reason Direct Marketers are paid.[28]

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27. The only exception being if the issuing institution cannot be contacted so that approval is given by VISA or MasterCard based upon criteria provided by the issuer.

28. If this were not the "reality" of Direct Marketers' involvement in the credit card systems, (in (continued...)

In addition to 24-hour approval capability, the California financial institutions which issue the VISA and MasterCard credits cards accepted by Direct Marketers are responsible for maintaining accounts and collecting on delinquent accounts. (Stip. para.'s 39, 40) Undeniably, for the California customers of Direct Marketers who use such credit cards for purchases, such activities occur in California, and, pursuant to section 6203(f), through acceptance of VISA and MasterCard credit cards, Direct Marketers engage in transactions connected to banking, financing, and debt collection in California.

The connections between California and the VISA and MasterCard systems, in which Direct Marketers participate, clearly include the establishment and maintenance of accounts, and the purchase approval provided by California financial institutions which issue VISA and MasterCard credit cards. The benefit to Direct Marketers of California providing the societal advantages permitting these financial institutions to function in this state are not open to dispute.

C. Direct Marketer's Sales are Sales on Approval Which Provide Additional nexus links.

Additionally, Direct Marketers provide their customers with promises of customer satisfaction which permit customers to receive a refund or replacement if, at any time, ordered merchandise is returned, and received by the Direct Marketer. (stip. para. 14.) Such sales, pursuant to the California (and Uniform) Commercial Code, are sales on approval.[29/30/]

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28. (...continued)
other words, if by obtaining approval codes Direct Marketers were not effectively guaranteeing payment from issuing institutions to Direct Marketers) why would acquiring banks provide Direct Marketers with the electronic authorization equipment and access to call authorization centers; why would the credit card relationship between Direct Marketers and acquiring banks only involve the submission of approved transactions; and, why would the discount fee paid by Direct Marketers be based in part upon the fees which must be paid for each credit card transaction to issuing institutions? All of these facets of the credit card transactions would not be involved if, as plaintiff would have this Court (incorrectly) conclude, all Direct Marketers' (in relative isolation) do is sell credit card receivables to acquiring banks.

29. Section 2326, California Commercial Code provides (in relevant part):
"(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is
"(a) A 'sale on approval' if the goods are delivered primarily for use, and
"(b) A 'sale or return' if the goods are delivered primarily for resale."
Section 2327, California Commercial Code provides (in relevant part):
"(1) Under a sale on approval unless otherwise agreed
"(a) Although the goods are identified to the contract the risk of loss and the title
(continued...)

As noted by the Court of Appeals in Gold'n Plump Poultry, Inc. v. Simmons Eng. Co., 805 F.2d 1312, 1319 (8th Cir. 1986), [31] in a Uniform Commercial Code ("UCC") sale on approval, title remains with the seller until acceptance by the buyer so long as the seller agrees that the buyer may return the goods even though the goods conform to the sales contract. The buyer need only "seasonably" return the ordered goods in order to be provided with a refund or replacement. (George v. Davoli, 397 N.Y.S. 895,897 (Ont. County 1977)) The only variation by Direct Marketers on the UCC-defined sale on approval, is allowed by California Commercial Code section 2327 and does not change the fact that Direct Marketers make sales on approval: the expense of return and any risk of loss in the return process rests with the buyer in the sales made by Direct Marketers. Therefore, until the customers of Direct Marketers accept the goods shipped into California, or until the "seasonable" period of time has elapsed, these goods, in California, remain the property of the Direct Marketers. This property, like the offices in National Geographic, supra, and the single independent contractor solicitor in Tyler Pipe Industries v. Washington, 483 U.S. 232, 250, (1987),[32] are afforded the direct benefit of California's police, fire and other government protections.

D. The Physical Mass of the Catalogs placed in California Provides Another "Nexus" Link.

Finally, the annual mail solicitations, generally catalogs, of California consumers by Direct Marketers dwarfs the 230,000 catalogs and flyers, involving 24-tons of solid waste, which only one company, Quill, produced in North Dakota. (Quill, supra, at 29, 33) The stipulations herein (stip., para. 9), paralleling the facts in Quill (at 10-11) reflect that mail solicitations are forwarded to persons whose names Direct Marketers obtain from independent sources, in other words, persons who have never

29. (...continued)
do not pass to the buyer until acceptance; and
"(b) Use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole;"

30. The Court in one of the Tennessee cases, SFA Folio, at 4, so concluded.

31. The poultry company sued for a refund of the purchase price of processing equipment and the district court dismissed the matter, a decision upheld by the appellate court. The poultry company argued the transaction involved a sale an approval, but the appellate court disagreed.

32. See also Standard Pressed Steel v. Washington Rev. Dept. 419 U.S. 560, 561-62 (1974)

requested the catalog. If the 198 companies which have either registered or received determinations from the Board (pursuant to section 6203(f)) engage in a minimum of 300,000 catalog solicitations each year, using the 24 tons of waste created by Quill as an average, the solid waste which must be disposed of in California (a "benefit" to Direct Marketers) could easily exceed 4,752 tons!

These catalogs clearly benefit Direct Marketers. The sheer bulk of a major Direct Marketer's catalogs within California is more than a match for a single office which even plaintiff would concede would create "nexus." The protection California provides to this property is similar to the protection California would provide to one office. The availability of disposal for this paper is certainly a direct benefit provided to Direct Marketers by the state. (Quill, supra, at p. 33-34.)

V

DIRECT MARKETERS' PURPOSEFUL DIRECTION OF ECONOMIC ACTIVITIES TO AND IN CALIFORNIA GIVES THIS STATE JURISDICTION TO REQUIRE USE TAX COLLECTION EVEN IF DIRECT MARKETERS HAVE NO PHYSICAL PRESENCE IN CALIFORNIA

The Supreme Court has held that states may require out-of-state entities to collect its use taxes when there is a "nexus"--"some definite link, some minimum connection"--between the entity and the state. National Geographic, 430 U.S. 561. The Supreme Court has found this requirement in both the due process and commerce clauses.

Nothing in the policies underlying the commerce or due process clause "nexus" requirements suggests that Direct Marketers should be exempt from state use tax collection requirements, particularly since the levy involved is a use tax. "The out-of-state seller becomes liable . . . only by failing or refusing to collect the tax from the resident consumer . . . [T]he sole burden imposed upon the out-of-state seller by [a use tax statute] is the administrative one of collecting it." National Geographic, 430 U.S. 558. It hardly offends traditional due process notions of fair play to "make the distributor the tax collector for the state" (General Trading Co. v. Tax Comm'n 322 U.S. 335, 338 (1944)) when Direct Marketers' intentional projection of their economic presence into the state has given rise to the taxed activity. Indeed, in an electronic age--and when, as here, sophisticated computer techniques allow for systematic exploitation of distant markets--it would be anomalous to hold that commercial entities may escape all taxation obligations by the states from which they draw substantial

benefits simply because they do not maintain a continuous physical presence there. Cf. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985); McGee v. International Life Insurance Co., 355 U.S. 220, 222-223 (1957).[33]

Under these precedents, California courts plainly could assert jurisdiction over a Direct Marketer if, for example, a California customer brought suit because he/she was injured by one of the products the Direct Marketer had shipped into California. See Burger King, supra, 471 U.S. at 473; World-Wide Volkswagen v. Woodson, 444 U.S. 286, 297-298 (1980); McGee, 355 U.S. at 223. There is no reason to suppose that a state nevertheless lacks authority to impose a duty to collect a tax on the Direct Marketer arising out of the same transaction. To the contrary, the Supreme Court held in the leading case of International Shoe Co. v. Washington 326 U.S. 310, 321 (1945)[34] that due process objections to personal jurisdiction and to state taxing authority must be judged by the same standard: "The activities which establish [the taxpayer's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." And that is hardly surprising since the same "minimum contacts" formula is the touchstone in each setting. (Compare, e.g. Burger King, supra, 471 U.S. at 474; World-Wide Volkswagen, supra, 444 U.S. at 291; International Shoe, supra, 326 U.S. at 316, National Geographic, supra, 430 U.S. at 561; Miller Brothers Co. v. Maryland 347 U.S. 340, 345 (1954).)

Of particular relevance here is the Supreme Court's observation in Burger King that:

> "[j]urisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum state. Although territorial presence frequently will enhance a potential defendant's affiliation with a state and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there." (471 U.S. at p. 476; emphasis added.)

The due process "nexus" requirement, with respect to state taxation, as the Supreme Court

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33. This conclusion draws significant support from the Supreme Court's decisions in the closely related area of personal jurisdiction. The Supreme Court has held that a "'forum State does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum State' and those products subsequently injure forum consumers." Burger King, 471 U.S. at 473, quoting World-Wide Volkswagen Corp. v. Woodson (1980) 444 U.S. 291, 297-298.

34. This case involved a personal jurisdiction and a state's jurisdiction to tax (see also Shaffer v. Heitner 433 U.S. 186, 203 (1977)).

has explained in describing the closely related due process limit on the assertion of personal jurisdiction, is grounded on the principle that states may not assert authority over out-of-state entities in a manner that "offend[s] 'traditional notions of fair play and substantial justice.'" (International Shoe, 326 U.S. 316 (citation omitted). See also World-Wide Volkswagen, supra, 444 U.S. 286, 292.) In the tax setting, this due process "fair play" principle assures that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the State." Wisconsin v. J.C. Penney Co. 311 U.S. 435, 444 (1940). The parallel commerce clause nexus requirement--the initial prong of the four-part Commerce Clause test first set out in Complete Auto 430 U.S. 287--is similar to (and in part derived from) the due process nexus limitation; it prevents a multitude of states from impeding interstate commerce by taxing transactions with which they have no substantial connection. (See also Goldberg v. Sweet, supra, 109 S.Ct. 589-590.)

VI

ASSUMING NATIONAL BELLAS HESS RETAINS ANY VALIDITY, CALIFORNIA MAY STILL CONSTITUTIONALLY REQUIRE USE TAX COLLECTION BY DIRECT MARKETERS

Plaintiff argues (rev. mem., pp. 8-10) that Direct Marketers are identical to the retailer in National Bellas Hess by citing the dissenting opinion of Justice Fortas in National Bellas Hess, which purported to relate the facts of that retailer's credit extension activities. The opinion of the Supreme Court never discusses that mail order catalog retailer's credit extension activities or the manner in which that retailer obtained payment for orders.[35] [36] Therefore, plaintiff's argument that in National Bellas

35. Chief Justice Charles Evans Hughes wrote the following statement in 1928:

"A dissent in a court of last resort is an appeal to the brooding spirit of the law, to the intelligence of a future day, when a later decision may possibly correct the error into which the dissenting judge believes the court to have been betrayed." (Hughes, The Supreme Court of the United States (1928), p. 68)

In National Bellas Hess, the three dissenting justices (Black, Douglas, and Fortas) stated a belief that "a realistic approach to the facts of appellant's business" would have led to an upholding of the tax in issue. (386 U.S. at 760) They noted that the affidavits upon which the case was tried did not disclose the details of the company's credit operations in Illinois, but they were willing to make certain assumptions that such credit business would lead to local activities. (Id. at 761-62) On the basis of these assumptions, the dissenters concluded that "Bellas Hess is not simply using the facilities of interstate commerce to serve customers in Illinois." (Id. at 762)

The majority in National Bellas Hess was unwilling to make these assumptions, basing its holding on the statement of fact that "[a]ll of the contacts which National does have with the State are via the United States mail or common carrier." (Id. at 754) (emphasis added) The majority simply refused to make the assumptions regarding local activities which the dissent was willing to draw from

(continued...)

Hess the Supreme Court rejected predicating "nexus" on a mail-order retailer's credit extension activities is specious.

Clearly, Direct Marketers communicate (including accomplishing sales) with and have connections with their customers by means in addition to the mail and common carriers. Direct Marketers participate in at least two nationwide credit extension and collection systems (VISA and MasterCard). For plaintiff to argue (rev. mem. p. 9) that this participation takes place outside California basically begs the question which National Bellas Hess poses. The question is whether a retailer's communications and connections with customers involve anything more than the mails and common carriers. If so, (as occurs with Direct Marketers) the inquiries are then whether the state asserting a use tax collection responsibility directly or indirectly provides benefits and services to the retailer or to the retailer's in-state activities. If these inquiries are answered affirmatively, a retailer's activities are subject to state taxation. The fact that a retailer uses the mails or common carriers to conduct its business will not, then, take away the state's ability to require use tax collection.

The benefits and services provided to the California institutions which issue the credit cards accepted by Direct Marketers directly benefit Direct Marketers, as do the benefits afforded Direct Marketers' property in California and the disposal of Direct Marketers' catalogs. Similarly, to the extent

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35. (...continued)
the facts that were present in the rather limited record.

If the courts were to make a general practice of using shortcomings pointed out in dissenting opinions, as plaintiff seeks, to broaden the scope of the majority opinions which were the targets of the dissenters, there would be a dangerous stifling of valuable dissent. Under those conditions, judges who conscientiously wished to point out what they perceived to be injustices resulting from misapplication of law or fact would hesitate to forthrightly set forth their dissenting views for fear that the shortcomings that they perceived in the majority opinion would later be turned around to add to the scope of the majority opinion and thus increase the perceived injustice. Under those conditions, the dissenting opinion could soon lose the noble function assigned to it by former Chief Justice Hughes.

36. Similarly, plaintiff's reliance on L.L. Bean v. Com., Dept. of Revenue ((Pa.Cmwlth. 1986) 516 A.2d 820, 821-25) is misplaced. The use tax statute at issue was silent with respect to a retailer benefitting from banking in Pennsylvania. Although the stipulated facts reflected L.L. Bean's acceptance of credit cards issued by Pennsylvania institutions, the facts are absent any details concerning the credit card systems and/or L.L. Bean's involvement therein, and the opinion never discusses credit card acceptance. For the same reasons, the reference to Bloomingdale's v. Dept. of Revenue (Pa.Cmwlth. 1989) 567 A.2d 773, is unavailing. Plaintiff's citation to SFA Folio Collection, Inc. v. Bannon, 585 A.2d 666 Conn. 1991), is meritless. In that case, the Court stated that retailer did not benefit from the Connecticut court system because the risk of loss "falls upon the credit card company." The stipulated facts herein reflect that Direct Marketers directly participate in the nationwide credit card systems which include activities in California.

the "physical presence" in California of the property of Direct Marketers, remains any prerequisite to an imposition of a use tax collection and remittance responsibility, Direct Marketers do, in fact, have property in California (catalogs and merchandise sold on approval).

VII

PLAINTIFF'S CLAIMS OF BURDEN ARE MERITLESS BOTH PRACTICALLY AND LEGALLY

The question before this Court is whether Direct Marketers can constitutionally be required to collect and remit California's use taxes pursuant to section 6203(f). Plaintiff's arguments regarding burden (rev. mem. pp. 15, et. seq.) are both legally and practically incorrect and advanced seemingly to transform the single legal issue to be decided in this case to one of national legal policy and insurmountable complexity. SBE seeks Direct Marketers' compliance with section 6203(f). Not before this Court is the question of whether as a matter of national law involving Direct Marketers and all the states, use tax collection should be a uniform nationwide requirement.

Pursuant to section 6203(j), Direct Marketers are required to collect and remit a single rate of use tax for all sales to California. Therefore, whether or not 44 other states and the local jurisdictions therein may also constitutionally require Direct Marketers to collect the use taxes of such other states (and local jurisdictions) is irrelevant.

In National Bellas Hess, 386 U.S. 759-60, the Supreme Court focused on the "virtual welter of complicated obligations to local jurisdictions" which would occur if every political subdivision could "entangle" each mail-order seller in administrative and record-keeping requirements. By comparison, at issue herein is the constitutionality of a single use tax rate coupled with a single state sales and use tax return which is submitted to a single state entity, SBE. [37] The "entanglement" rationale of the National Bellas Hess decision has no application to this case.

Nothing whatsoever in the record of this case supports plaintiff's contentions regarding the

37. Plaintiffs's reference to the point-of-sale retailer not facing the "burden" of multiple jurisdiction sales tax collection (rev. mem. pg. 16) borders on the absurd. In California, the local retailer must pay the state, as well as any local, sales taxes applicable to each separate location. A retailer with more than one location in more than one local jurisdiction could find itself required to collect varying rates of California sales tax (as now occurs, for example, for "chain" retailers with locations in and out of the "BART" counties). Such retailers have administrative and bookkeeping requirements which do not burden Direct Marketers subject to the single California use tax rate.

expenses of and consequences (for example, lost catalog space) of notifying customers of any jurisdiction's use tax requirements. These arguments (not fact) ignore the undisputed facts that most sales by Direct Marketers are accomplished through the acceptance of credit cards and that customers have access to "800" telephone numbers of every Direct Marketer. (Stip. para.'s 12, 15.) Direct Marketers are not prevented from informing customers of California single use tax rate, when customers call an "800" number and place an order using a credit card. In addition, Direct Marketers obviously face collection requirements if, for whatever reason, customers who place mail orders fail to remit the proper amount. Finally, just as computers allow Direct Marketers to process telephone orders from every corner of the country, to seek approval for every credit card sale, and (for some Direct Marketers) to generate computer entries for every credit card charge, computer technology (software) is available to Direct Marketers for billing and remitting of use taxes.[38]

VIII

CONCLUSION

Summary judgment should be entered in favor of the defendants.

DATED: June 14, 1991.

Respectfully submitted,

DANIEL E. LUNGREN
Attorney General

JAMES B. CUNEO
Supervising Deputy Attorney General

STEVEN J. GREEN
Deputy Attorney General

Attorneys for Defendants

38. See Hartman, supra, at 1011-12. Such software fills an obvious need as many firms have both local store and mail order components, and/or stores in jurisdictions with various rates and are thus required to collect and remit more than one tax rate to possibly more than one jurisdiction. Also, it defies logic to assume that Direct Marketers with at least $500,000 and possibly in excess of $10,000,000 in California sales alone, are conducting business utilizing modern computer technology in everything but internal accounting.

DECLARATION OF PERSONAL SERVICE

Case Name: DMA v. Bennett, et al. No. S88-1067 MLS

I declare:

I am employed in the County of Sacramento, California; I am 18 years of age or older and not a party to the within entitled cause; my business address is 1515 K St., P. O. Box 944255, Sacramento, California 94244-2550.

I served the attached:

DEFENDANTS' MEMORANDUM OF POINTS & AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN FAVOR OF SUMMARY JUDGMENT FOR DEFENDANTS

by personally delivering a true copy thereof to each of the following names persons on the date and at the address as follows in said cause:

NAME/ADDRESS	DATE
John A. Mendez Downey,m Brnad, Seymour & Rohwer 555 Capitol Mall, 10th Floor Sacramento, CA 95814-4686	June 14, 1991

I declare under penalty of perjury the foregoing is true and correct, and that this declaration was executed at Sacramento, California on June 14, 1991.

STEVEN J. GREEN

DECLARATION OF SERVICE BY FAX

Case Name: DMA v. Bennett, et al. No. S88-1067 MLS

I declare:

I am employed in the County of Sacramento, California; I am 18 years of age or older and not a party to the within entitled cause; my business address is 1515 K St., P. O. Box 944255, Sacramento, California 94244-2550.

I served the attached:

DEFENDANTS' MEMORANDUM OF POINTS & AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN FAVOR OF SUMMARY JUDGMENT FOR DEFENDANTS

by Faxing a true copy thereof to each of the following named persons on the date and at the phone number as follows in said cause:

NAME/ADDRESS	DATE
Martin Eisenstein (207) 783-9325	June 14, 1991

I declare under penalty of perjury the foregoing is true and correct, and that this declaration was executed at Sacramento, California on June 14, 1991.

STEVEN J. GREEN

(2)

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Attorneys for Plaintiff

FILED
JUL 12 1991
CLERK, U. S. DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA
BY _____ DEPUTY CLERK

LODGED
JUL 8 1991
CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA
BY _____ DEPUTY CLERK

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

DIRECT MARKETING ASSOCIATION INC., Plaintiff, v. WILLIAM M. BENNETT, et al., Defendants.	No. CIVS-88-1067 MLS ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This matter came on for hearing on June 28, 1991, on the motion of Plaintiff DIRECT MARKETING ASSOCIATION, INC. for summary judgment and the cross-motion of Defendants WILLIAM M. BENNETT, et al. for summary judgment. Plaintiff was represented by George Isaacson of Brann & Isaacson and John A. Mendez of Downey, Brand, Seymour & Rohwer. Defendants were represented by Steven J. Green, Deputy Attorney General, State of California.

The Court, having read and considered the motions, memoranda of points and authorities, stipulated facts, and affidavits submitted both in favor and in opposition thereto, and having

DOWNEY BRAND SEYMOUR & ROHWER

heard the oral arguments of counsel, rendered its decision granting Plaintiff's motion for summary judgment and denying Defendants' cross-motion for summary judgment, in open court at the conclusion of the hearing. A transcript of the Court's decision is attached hereto and incorporated herein by reference. Good cause appearing therefor:

IT IS ORDERED that Plaintiff's motion for summary judgment in the above-captioned action is GRANTED.

IT IS FURTHER ORDERED that Defendants' cross-motion for summary judgment in the above-captioned action is DENIED.

Dated: July 12, 1991.

MILTON L. SCHWARTZ
U. S. DISTRICT COURT JUDGE

WEST2-24026

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1 IN THE UNITED STATES DISTRICT COURT
2 FOR THE EASTERN DISTRICT OF CALIFORNIA
3 ---o0o---
4 BEFORE THE HONORABLE: MILTON L. SCHWARTZ, JUDGE
5 ---o0o---
6 DIRECT MARKETING,)
7)
Plaintiff,)
8)
vs.) NO. Civ S-88-1067
9)
BENNETT, et al.,)
10)
Defendants.)
11)
12 ---o0o---
13 REPORTER'S TRANSCRIPT
14 JUNE 28, 1991
15 ---o0o---
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17 Reported by: JANE E. BEAUCHAMP, CSR #6408
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APPEARANCES:

2

3 For the Plaintiff:

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10

11 For the Defendants:

12 DEPARTMENT OF JUSTICE
Office of the Attorney General
13 1515 K Street, Suite 511
Post Office Box 944255
14 Sacramento, CA 94244-2550
BY: STEVEN J. GREEN,
15 Deputy Attorney General

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1 SACRAMENTO, CALIFORNIA, FRIDAY, JUNE 28, 1991

2 2:00 P.M.

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4 THE COURT: The following constitutes the decision

5 of the Court on these cross-motions for summary judgment.

6 Plaintiff, Direct Marketing Association, Inc.,

7 filed this section 1983 action on behalf of its members

8 seeking declaratory and injunctive relief.

9 The controversy arose when defendants, individual

10 members and officers of the California Board of

11 Equalization demanded that plaintiff's members collect a

12 use tax from their California customers if they, one,

13 maintain substantial and recurring solicitations of and

14 sales to California customers; and two, accept credit

15 cards issued by California financial institutions.

16 Plaintiff contends that imposition of use tax liability

17 in this case is unconstitutional because there is an

18 insufficient connection between California and the

19 members it seeks to tax.

20 The Supreme Court has held that under the due

21 process CLAUSE of the 14th amendment and the commerce clause, a

22 state may not impose the burden of use tax collection

23 against an out-of-state entity unless there is a

24 sufficient nexus between the state and the entity.

25 National Bellas Hess, Inc. vs. Department of Revenue of

1 the State of Illinois, 386 U.S. 754 (1967). In applying
2 that rule, the Court has found a sufficient nexus where
3 the out-of-state entity has a place of business,
4 employees or property within the state. It has found the
5 nexus insufficient where the only connection with
6 customers in the taxing state is by common carrier or the
7 United States mail.
8 According to the facts presented to the Court by
9 stipulation of all parties in this case, plaintiff's
10 members do not have offices, outlets, stores, warehouses
11 or other facilities, stocks of goods, real property or
12 employees in California. They do not have agents,
13 independent contractors, or representatives soliciting
14 sales in California. They do not maintain bank accounts
15 in California. They do not ship products to California
16 customers from any location in California. Plaintiff
17 contends that in light of these facts, the Supreme
18 Court's holding in National Bellas Hess compels this
19 Court to rule that defendants' imposition of use tax
20 liability is unlawful.
21 Defendants, however, contend that plaintiff
22 interprets the sufficient nexus test too narrowly.
23 According to defendants, there is sufficient nexus in
24 this case because plaintiff's members accept credit cards
25 issued by California financial institutions. The parties

1 agree that a substantial portion of the credit card sales
2 to California customers are charged to the customers'
3 VISA and MasterCard credit cards issued by California
4 banks. Defendants argue that other factors also weigh in
5 favor of a finding of nexus, including the fact that
6 defendants' advertisements and catalogues generate
7 literal garbage which must be disposed of by the state,
8 and the fact that sales to California residents require
9 California 800 line telephone calls, debt collection in
10 this state, and frequent shipments to California on state
11 highways.
12 Defendants also contend that a rigid application
13 of the doctrine articulated in National Bellas Hess is
14 improper for several reasons. They contend that because
15 the direct marketing industry has grown dramatically
16 since National Bellas Hess was decided in 1967, the
17 doctrine of that case is obsolete. They also contend
18 that since the Supreme Court has expanded its notion of
19 what constitutes "minimum contact" with respect to
20 personal jurisdiction, it is reasonable to assume that
21 the Court is moving in the same direction with respect to
22 sufficient nexus and use tax liability.
23 This Court does not find these arguments
24 persuasive. The Court does not find use of California
25 financial institutions or any of the other factors

1 mentioned by defendants to be comparable to the
2 maintenance of retail outlets, employees, or property
3 within the State. Additionally, although the direct
4 marketing industry may have only been a fraction of its
5 current size at the time the case was decided, the sales
6 transactions which took place between Bellas Hess and its
7 Illinois customers clearly required reliance on Illinois
8 financial institutions. The dissent found this
9 significant in terms of meeting the sufficient nexus
10 test, but clearly the majority did not.
11 Furthermore, defendants' contention that
12 International Shoe Company vs. Washington, 326 U.S. 310
13 (1945), stands for the proposition that the test for
14 minimum contacts is or should be interchangeable with the
15 test for sufficient nexus. The Court finds that this
16 conclusion or reading of International Shoe is erroneous.
17 Although the Court stated that the activities of the
18 taxpayer in the taxing state subject it alike to taxation
19 by the state and to suit to recover the tax, the Court's
20 ruling was limited to the facts before it. Of course,
21 the factors which are relevant to a determination of
22 minimum contacts may also be relevant to a determination
23 of sufficient nexus. Nonetheless, the two doctrines are
24 distinct.
25 Defendants additionally argue that during the

1 short time prior to customer acceptance, the goods
2 plaintiff's members shipped to California residents
3 remain the property of the members. Defendants conclude
4 that because this property enjoys California police and
5 fire protection, plaintiff's members are receiving a
6 benefit from the state which justifies imposition of use
7 tax liability. The Court does not agree with this
8 analysis. Title to the goods in question remains with
9 the seller only where the sales are sales on approval
10 pursuant to Uniform Commercial Code Section 2-326. There
11 is no evidence or facts before the Court indicating the
12 sales by plaintiff's members are on approval. The
13 general presumption runs against delivery to a customer
14 being a sale on approval. Gold 'N Plump Poultry, Inc.
15 vs. Simmons Engineering Company, 805 Federal Second 1312
16 (Eighth Circuit 1988). In any event, a ruling in favor
17 of plaintiff on this motion would not preclude defendants
18 from imposing a use tax against an out-of-state retailer
19 who maintained property in this state.
20 In sum, although defendants have raised a number
21 of meritorious arguments as to why National Bellas Hess
22 should be reconsidered or reversed or modified, this
23 Court feels it is still bound by it. Consequently, the
24 Court concludes that in the absence of a clearly
25 distinguishing feature, defendants cannot lawfully

1 require plaintiff's members to collect and remit a use
2 tax on sales to California customers solely on the basis
3 that those members maintain substantial and recurring
4 solicitations and sales to California customers and
5 accept credit cards issued by California financial
6 institutions. Accordingly, the Court is compelled to
7 grant plaintiff's motion for summary judgment and does do
8 so hereby and denies defendants' cross-motion for summary
9 judgment.
10 MR. ISAACSON: The only question I have, since
11 summary judgment is being entered, it resolves all the
12 issues in the case, is judgment also being entered in
13 plaintiff's favor?
14 THE COURT: That follows the granting of the
15 motion for summary judgment.
16 Also, the affidavit of Stephen Clegg filed on
17 behalf of plaintiff on June 21, 1991, is stricken.
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2 CERTIFICATE OF COURT REPORTER

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7 I, JANE E. BEAUCHAMP, Official Reporter,

8 certify that the foregoing pages constitute a true and

9 correct transcript of the testimony contained therein as

10 reported by me and thereafter reduced to typewriting to

11 the best of my ability.

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15 July 2, 1991.

16

17 JANE E. BEAUCHAMP, CSR #6408
Official Shorthand Reporter

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DECLARATION OF MAILING
(CCP Section 1013a(3))

I am a citizen of the United States, over eighteen years of age and not a party to the within action. My business address is 555 Capitol Mall, 10th Floor, Sacramento, California, 95814. I am readily familiar with my employer's practice for the collection and processing of correspondence for mailing with the United States Postal Service that same day in the ordinary course of business. On July 8, 1991 I served the following: **ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** by placing a copy thereof in a sealed envelope with postage fully prepaid thereon for collection and mailing on that date following ordinary business practices addressed as follows:

Steven J. Green, Esq.
Office of the Attorney General
Post Office Box 944255
Sacramento, California 94244-2550

I declare under penalty of perjury that the foregoing is true and correct. Executed on July 8, 1991 at Sacramento, California.

Paula S. Grenz
PAULA S. GRENZ

DOWNEY
BRAND
SEYMOUR
& ROHWER

(4)

Medline Industries, Inc.
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1.847.643.4603 Phone
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VIA FAX 559-312-2929

May 29, 2007

Mr. Albin C. Koch
c/o Carrie Toomey
MuniServices LLC
Suncast Lane
El Dorado Hills, CA

Re: Delivery Obligations of Internet Retailers

Dear Mr. Koch:

My name is Susan Russell, and I am a corporate attorney with 10years' experience working with companies that make sales to consumers and others via the internet. For a number of years I was employed as Associate General Counsel of Sears, Roebuck & Co. which has at least one subsidiary engaged in making internet sales.

You have asked what delivery obligation the internet industry generally accepts inmaking sales via the internet. For example, does the delivery obligation terminate upon shipmentvia common carrier from storage facilities to the customer or do they typically continue to be responsible for and own the goods shipped until after actual delivery to the customer occurs?

My experience is that the marketplace demands that internet retailers remain responsible for the goods that they ship until after actual delivery to the purchaser. This because internet purchasers are not willing to purchase from websites before they actually can see the goods being purchased to make sure they fit their orders. This industry practice has helped make internet selling more andmore successful.

Often people experienced with internet selling will refer to this practice as selling "FOB destination," even though no such language is posted on the website, because in business terms, that is what their shipping and delivery responsibility is.

Yours very truly,

Susan Russell
Medline, Inc.
Director of Tax and Insurance.

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Report for MuniServices LLC and the Attorney(s) Representing MuniServices, LLC
Prepared by Patrick A. Scholten, Ph. D.
Date: Sunday, July 15, 2007

1. Introductions

In this report I will discuss a brief history of traditional retail markets, the different type of retail Internet entities along with their pros and cons, and various internal functional areas required to operate and maintain a successful retail Internet business. The discussion then moves to describing the legal and contractual formats utilized to transfer ownership of goods in retail Internet goods markets.

2. Retail Internet Business Structures and Internal Operations

2.1 Traditional Retail Market Background

This background information helps set the stage for the evolution of how to run a successful Internet retail operation. Similar issues that faced retailers in the 1870's and 1900's are cropping up again as the Internet changes the retail landscape.

Traditional means for retailers to sell their products was by renting or purchasing property where the physical entity (retail outlet) would reside and consumers would visit the outlet, inspect the goods' various characteristics and decide to purchase or not. The geographic reach of these traditional retail outlets was limited to consumers in the surrounding areas. To broaden its consumer base, traditional retailers had to rent or purchase additional property to set up another outlet. Not only was this costly, but managing geographically-disparate entities could prove to be problematic.

The traditional retail model confers both costs and benefits to consumers. On the benefit side, consumers could visit the entity and inspect the goods prior to making a purchase decision. Additionally, consumers could establish relationships with the store owners and other individuals working at the retail outlet. Thus, a trust relationship was built over time between the retailer and consumer. Consumers, however, incurred search costs each time they visited the retailer. This cost might come in the form of "shoe leather" costs (the explicit cost of travel to and from the physical outlet – such as gas or the bottoms of one's shoe). There is also an implicit cost of the time it takes a consumer away from other activities.

In 1872, Aaron Montgomery Ward established the first mail-order retail business. Ward's strategy was important for several reasons. First, creating a mail-order retail operation permitted a retailer to reach consumers in remote geographic areas, without incurring the fixed costs of setting up a retail outlet in each location. Second, it reduced consumers' search costs since consumers could simply thumb through the catalogue to find the item they wanted to purchase. Setting up a large-scale retail operation required that retail outlets be placed throughout the United

States. The cost of creating a mail-order retail business, however, was that the consumer had to trust that the retailer would deliver the promised items once transfer of payment had occurred. In addition, mail-order retailers had to make a cost-benefit analysis of which items to include in a catalogue. That is, only a subset of products could be advertised in a catalogue.

Ward's initial success was modest at best and faced significant opposition from rival local retailers in rural areas. Part of Ward's success was based on an innovative and (at the time) unprecedented company policy that gave consumers a "satisfaction guarantee or your money back." Since consumers shopping via catalogue could only see a picture and written description of an item, and not physically inspect it, Montgomery Ward's satisfaction guarantee policy was an integral part of gaining consumers' trust and its early success in the catalogue business. After a couple of decades and facing significant competition from its rival Sears, Roebuck and Company, Ward decided to open a retail outlet in Chicago and other outlets followed.

This brief history sets the stage for how competition on the Internet has evolved and will evolve in the future. While the lesson from the Montgomery Ward-Sears Roebuck rivalry suggests that retailers with a multi-channel distribution network will prevail, there are several reasons to expect an equilibrium to prevail consisting of a combination of Internet-only retailers and hybrid retailers that have both an Internet operation combined with one or more physical, traditional retail outlets. More importantly, however, the story illustrates the long-time origin of the money-back guarantee that is prevalent in today's retail Internet business. This policy illustrates a long-standing tradition, and the subsequent legal framework, among retailers that true ownership is not final until after taking possession of the good. Indeed, true transfer of ownership only takes place after a period extending beyond physical possession of the item.

2.2 Key Retail Internet Business Structures

There are two broad structures available to retailers using the Internet as a distribution channel. The first type of structure is a "pure-play" Internet retailer. This type of retailer only distributes goods over the Internet. It does not have a physical location where consumers can go to browse and inspect goods prior to purchasing them. Instead, pure-play Internet retailers have a virtual "storefront" where it displays physical and written descriptions of each of its products on its website. Once the main website is set up, maintenance of the product information on the website is as simple as changing information contained in a database to which the website is linked. Instead of having a physical location for consumers to visit, the pure-play retailer only needs a warehouse to store and ship goods. The obvious advantage is lower overhead costs to operate a physical facility that is appealing to consumers and not having to employ a trained sales force. On the other hand, it may

be necessary for the pure-play retailer to hire the professional services of a web design company.

The second entity structure utilized by retailers distributing goods via the Internet is a hybrid retailer that has both one or more physical retail outlets and a virtual storefront. While this structure is certainly more costly on many dimensions (cost of maintaining several locations, sales staff, cost of a web design firm or division), the cost of maintaining this type of structure may be offset by the benefit, depending on the retailers' strategy.

There are several things to consider in selecting a business structure. The business-structure decision impacts the retailers' cost structure. Based on a cost structure, a retailer can select a strategy to most effectively compete in the market.

2.3 Internal Operations

2.3.1 Management Team

Retail Internet markets are extremely competitive and the management team is responsible for creating the company vision and ensuring that the other functional areas of the company are executing that vision. Given the dynamic nature of these markets, the management team must respond quickly to changes in the market.

2.3.2 Marketing Department

Successful large-scale Internet retailers have a multi-faceted marketing department. The functional areas associated with the team are merchandise selection; pricing and promotional activities; general policy selection such as credit policies, return policy, et cetera; ensuring that the virtual store is easy to navigate and has the psychological attributes that are comforting to consumers; providing visual images and written descriptions of the products; researching the demographic characteristics of its primary consumers; and executing and managing the company image and vision created by the management team.

Product lifecycle for many products sold on the Internet are relatively short. That means a team of individuals have to be constantly managing the inventory of existing products by adjusting prices and monitoring competitors' pricing activities. In addition, a worldwide team of buyers have to constantly be looking for new products and negotiating with vendors.

2.3.3 Inventory and Warehouse Management Engineers

A team of engineers is necessary to design and maintain an inventory control system. Effectively and efficiently running a large-scale operation requires a real-time intelligent information process warehouse and inventory system that automates and controls all aspects of the warehouse. This system would

inform consumers whether the product of interest is available prior to purchasing. If properly managed, such a system would also minimize inventory requirements by automatically flagging restocking when it reached a defined threshold.

Warehouse design to accommodate a real-time intelligent system is extremely important. For instance, once consumers initiate an order via the website, an automated warehouse system will have material handling equipment in place to know where that product is located in the inventory racks, be able to retrieve the product, package and place a shipping label on the product to be shipped out with the next delivery. This process can happen anytime of the day with minimal manual labor. However, a team of engineers are required to develop and maintain such an intricate system. The ability to automate this inventory and distribution systems has a dramatic impact on an organization's efficiency and profitability.

2.3.4 *IT Department*

The IT department is the lubricant that makes the marketing and real-time intelligent system in the warehouse function smoothly. The marketing and inventory information content reside in databases, which is stored and managed on servers. These servers could be either owned by the retailer or leased space managed and operated by an Internet hosting company.

This team of individuals takes the marketing content – like digital photos and product descriptions – to create a database of products and ensures that it is properly displayed on the retailer's website. In addition, this team develops and maintains the linkage with the warehouse so that consumers know whether the product is available or when the inventory needs to be restocked.

Internet security is the root of all Internet retailers business. The IT department is ensuring that the shopping environment is secure for consumers so that personal information (i.e. credit card information) is not disseminated to unauthorized individuals. The technology required to maintain this aspect of the business is constantly being changed and updated. Security breaches could ruin an Internet retailer's reputation and business.

2.3.5 *Other Information Pertaining to the Efficiency of Internal Operations*

The close linkages between the internal functional areas require that each department work closely with one another. Therefore, operating a large-scale retail Internet business is most efficiently operated with all of the functional areas in the same geographic location.

3. **Standard Legal and Contractual Format for Ownership Transfer in Retail Internet Markets**

In many ways transfer of ownership of items in retail Internet markets parallels that of the mail-order catalogue market. Consumers find a product they want to purchase. Once the consumer has made a purchase decision they can inform the retailer of their "order" decision by providing product and payment information over a secure Internet connection.[1] When an order is communicated to an Internet retailer over a secure Internet connection, the retailer will send an automated email confirmation that provides essential information about the purchase. The retailer ships the item and ownership is transferred when the consumer receives 1) the bill of sale or receipt and 2) the physical item.

According to the Federal Trade Commission's (FTC) Facts for Consumers' Guide "Billed for Merchandise You Never Received? Here's What To Do" the company is obligated to ship an order with the time stated in an advertisement. In circumstances where no delivery time is promised, the retailer has up to 30 days after receiving the order to process and ship the item. According to the FTC Facts for Consumers' Guide, the one exception to this rule is that "If a company doesn't promise a shipping time, and you are applying for credit to pay for your purchase, the company has 50 days to ship after receiving your order."

According to the FTC Facts for Consumers' Guide "The Cooling-Off Rule: When and How to Cancel a Sale" when consumers purchases an item from a store's permanent physical location they may not be able to return a previously purchased item. However, when consumers purchase items at a location other than the seller's permanent place of business, The Cooling-Off Rule extends your right to cancel an order for a full refund extends until midnight of the third business day after the sale.

Internet retailers often have a more liberal return policy than that permitted under the FTC's Cooling-Off Rule. A sampling of online retailers revealed that items could be returned to seller between 10 to 30 days on most items.[2]

Patrick A. Scholten

Patrick A. Scholten

July 15, 2007

Date

[1] In 1996, the United States Congressional Budget Office conducted a study entitle "Emerging Electronic Methods for Making Retail Payments," that discusses the forms of payment being accepted by online (and other) retailers.
[2] Some items are not returnable.

4. **References**

Federation of Tax Administrators: State Sales Tax Rates: http://www.taxadmin.org/FTA/rate/sales.html

FTC Facts for Consumers "Billed for Merchandise You Never Received" Here's What To Do"

FTC Facts for Consumers "The Cooling-Off Rule: When and How to Cancel a Sale"

"Internet Sales Tax Fairness." The Hometown Advantage: Reviving Locally Owned Business: http://www.newrules.org/retail/inttax2.html

Montgomery Ward, from Wikipedia: http://en.wikipedia.org/wiki/Montgomery_Ward

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Home Page: www.nash-equilibrium.com/scholten/index.php

PERSONAL
Born November 20, 1968; married, 1 child; U.S. citizen

EDUCATION
Ph.D. (Economics), Indiana University, August 2003
M.A. (Economics), Indiana University, December 2000
B.A. (Economics), Michigan State University, December 1992

DISSERTATION
Title: "The Economics of Retail Pricing on the Internet"

FIELDS OF RESEARCH
Industrial Organization, Game Theory and Strategy, and Applied Econometrics

PUBLICATIONS & ACADEMIC RESEARCH

PUBLISHED & FORTHCOMING PAPERS

- "A Review of Three Directed Acyclic Graphs Software Packages: MIM, Tetrad, and WinMine." (with Dominique Haughton and Arnold Kamis), *The American Statistician*, August 2006, 60(3), 272-286.

- "Information, Search and Price Dispersion" (with Michael R. Baye and John Morgan) in Handbook on Economics and Information Systems (T.J. Hendershott, Ed.), Amsterdam: Elsevier, forthcoming.

- "Temporal Price Dispersion: Evidence from Shopper.com" (with Michael R. Baye and John Morgan), *Journal of Interactive Marketing*, Autumn 2004, 18 (4), 101-115.

- "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site" (with Michael R. Baye and John Morgan), *Journal of Industrial*

BRS-00266

Economics, December 2004, 52 (4), 463-496. Winner of the 2004 Journal of Industrial Economic "Best Article Prize."

- "Persistent Price Dispersion in Online Markets" (with Michael R. Baye and John Morgan) in The New Economy and Beyond: Past, Present and Future (D.W. Jansen, Ed.), Edward Elgar, forthcoming.

- "Price Dispersion, Product Characteristics, and Firms' Behaviors: Stylized Facts from Shopper.com" (with Jihui Chen) in *Advances in Applied Microeconomics* (M.R. Baye, Ed.), JAI Press, 2003.

- "The Value of Information in Online Markets" (with Michael R. Baye and John Morgan), *Journal of Public Policy and Marketing*, Spring 2003, 22 (1), 17-25.

- "Price Dispersion Then and Now: Evidence from Retail and E-tail Markets" (with Adam Smith) in *Advances in Applied Microeconomics* (M.R. Baye, Ed.), JAI Press, 2002.

Working Papers & Research In Progress

- "The Nature of Sales in Online Markets: Asymmetric Consumer Information or Benefits to Bulk Shopping?" (with Jihui Chen and Jeffrey Livingston)

- "Pricing Behaviors of Firms on the Internet: Evidence from Price Comparison Sites Cnet and Nextag." (with Yu-Chen Lin)

- "The Propensity to Advertise Price Online: Evidence from Shopper.com." (with Jeffrey Livingston)

- "A Structural Equation Model of Gambling and Vice Expenditures in the UK" (with Dominique Haughton, David Gulley and Arnold Kamis)

Other Publications

- *Instructors Manual to Accompany Managerial Economics and Business Strategy*, 5th Edition (with Michael R. Baye), 2005.

Professional Experience

Teaching Experience

- Assistant Professor, Bentley College, Department of Economics, *present – Fall* 2003.
  Business Statistics.
  The Economics of Internet Technology.
  Industrial Organization and Markets.
  The Economics of Antitrust and Regulation.

BRS-00267

- Visiting Lecturer, Indiana University, Department of Business Economics and Public Policy, *Summer* 2002 – *Summer* 2003.
  Business and Economic Strategy in the Public Arena.

- Associate Instructor, Indiana University, Department of Economics, *Fall* 1999 – *Spring* 2000.
  Principles of Microeconomics.

- Teaching Assistant at Indiana University, Department of Economics, *Fall* 1997 – *Fall* 1998.
  Principles of Microeconomics.
  Introduction to Business Statistics.

TEACHING INTERESTS

Industrial Organization, Managerial Economics, Applied Game Theory, Applied Econometrics, Business Statistics.

ACADEMIC

- Research Assistant at Indiana University for Michael Baye. *Summer* 1998 – *Spring* 2002.

NON-ACADEMIC

- Consultant, Unext 2001

- Analyst, BankAtlantic 1994 – 1997

CONFERENCE PRESENTATIONS AND PARTICIPATION

- European Association for Research in Industrial Economics (EARIE), Amsterdam, Netherlands, August 2006. Paper Presented: "Pricing Behaviors of Firms on the Internet – Evidence from Price Comparison Sites CNet and NexTag."

- Southern Economic Association Conference, Washington, D.C., USA, November 2005. Paper Presented: "The Timing and Nature of Price Adjustments in Electronic Retail Markets: Evidence from a Price Comparison Site."

- 4th ZEW Conference on the Economics of Information and Communication Technologies, Mannheim, Germany, July 2 – 3, 2004. Paper Presented: "The Propensity to Advertise Price Online: Evidence from Shopper.com."

- University Research Conference, National Bureau of Economic Research, Cambridge, Massachusetts, May 7 – 8, 2004. Paper Presented: "The Propensity to Advertise Price Online: Evidence from Shopper.com."

BRS-00268

- International Industrial Organization Conference, Chicago, Illinois, USA, April 23 – 24, 2004. Paper Presented: "The Propensity to Advertise Price Online: Evidence from Shopper.com."

- Southern Economic Association Conference, San Antonio, Texas, USA, November 20 – 23, 2003. Paper Presented: "The Propensity to Advertise Price Online: Evidence from Shopper.com."

- Bentley College, Department of Economics, February, 2003. Paper Presented: "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site."

- University of Wyoming, Department of Economics and Finance, January, 2003. Paper Presented: "The Propensity to Advertise Price Online: Evidence from Shopper.com."

- Grand Valley State University, Department of Economics, January, 2003. Paper Presented: "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site."

- Indiana University, Department of Business Economics and Public Policy, November 2002. Paper Presented: "The Propensity to Advertise Prices Online: Evidence from Shopper.com."

- Southern Economic Association Conference, New Orleans, Louisiana, USA, November 25-26, 2002. Paper Presenting: "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site."

- Indiana University, Department of Economics Microeconomics Workshop, September 4, 2002. Paper Presented: "The Economics of Retail Pricing on the Internet."

- World Congress of the Econometric Society, Seattle, Washington, USA, August 2000.

- NATO Advanced Study Institute: Stochastic Games and Applications, Stony Brook State University of New York, July 7 – 18, 1999.

ACADEMIC AWARDS AND HONORS

- 2004 Best Article Prize, *Journal of Industrial Economics* for "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site" (with Michael R. Baye and John Morgan).

- Fred and Judy Witney Scholarship Award presented by Indiana University, 2003.

BRS-00269

Professional Activities

Refereeing

Economic Inquiry, Information Economics and Policy, National Science Foundation, Review of Industrial Organization.

Professional Affiliations

American Economic Association, Industrial Organization Society, and the Southern Economic Association.

(6)

WWW.

Shipment Summary

Ordered by:
Sandra Heuer

USA

Received by:
Sandra Heuer

USA

SHIPMENT DATE	SHIPPED VIA	TRACKING #	ORDER #
09/06/02			2677025176353

			Unit Price	Amount
1	9736338284	Jimmy Neutron	$19.95	$19.95
			Subtotal	$19.95
			Shipping	6.88
			Tax	1.64
			Total	$28.47

TC# 09004721831020029270[illegible]6276 UCC# 20020906-055858-284-091

Thank you for shopping at .com!

Didn't receive your entire order?
You may receive your order in separate shipments. If your entire order did not arrive in this shipment, you can track the status of your order at www. .com/tracking.

Questions about your order?
Call us at 1-800-966-6546, or visit our Web site at www. .com. We're happy to answer your questions, and we're committed to making your shopping experience easy and pleasant

Want to make a return?
If you are not satisfied with your order, please refer to the Returns Information on the back of this invoice or on a separate sheet.

AIRBORNE EXPRESS

Returns Information

Your complete satisfaction is our number one priority. If any item you order from us does not meet your expectations, simply return it to us by one of the methods described below.

To Return an Item to a Store

1. Take the item with all original packaging and accessories, plus the invoice (including this sheet) to the Customer Service Desk at your local
2. An associate will issue a credit to the original credit card or provide a store credit.

Please note: **Computer hardware and components must be returned by mail.** Simply use the provided return label and follow the instructions for returning items by mail.

To Return an Item by Mail

1. Fill out the Reason for Return section below.
2. Box the item securely. Enclose the invoice (including this sheet), plus all original packaging and accessories.
3. Use the provided prepaid return label and ship via U.S. Postal Service (USPS).
4. We will issue a credit to the original credit card. Please allow two billing cycles for the credit to appear on the credit card's printed statement.

Reason for Return
To help us serve you
__Changed my mi
__Wrong item
__Wrong size

Other Return Details

- **Store Gift Cards** (shopping cards) are not returnable or refundable.
- For **oversize or perishable** items, please call our Help Desk at 1-800- for assistance.
- We cannot accept mail returns of items purchased in stores or .
- If you were sent an **incorrect, damaged or defective** product, we will issue credit for any applicable shipping and gift wrapping charges.
- **CDs, DVDs, audiotapes, videotapes, video games and computer software** must be returned unopened within 45 days of receipt
- **Books** must be returned unused and unmarked within 45 days of receipt.
- **Computer hardware and components** must be returned with any included software within 15 days of receipt. Other electronics items must be returned within 90 days of receipt.

Exchange Information

To exchange an item by mail, please fill out the two lines below, indicating the item you are returning and the new item you would like sent. Enclose this information with your return. Please be as specific as possible when describing the new item. For example, give the item name, color, size, etc.

The item returned will be credited to the original credit card and the new item(s) will be charged to the same card. Gift items are not exchangeable by mail. If returned, they will be credited to the original credit card. Shipping charges for the returned item are not refundable and shipping will be charged for the new item(s)

Items to Be Exchange
Item Returned:
New Item Descripti

Thank you for shopping at .com. **We look forward to serving you in the future!**

Problems With Your Order

More Help: Ordering
Go to Help main page
Go to Ordering main p

An Item Is Missing
My Order Didn't Arrive
An Item Is Damaged or Defective

An Item Is Missing

Sometimes because of varying item availability and warehouse locations, you may receive more than one shipment when you place an order with multiple items. We will not charge you extra for split shipments. The invoice you receive with your order will tell you which items have been shipped separately. If you still have questions about items missing from your order, please contact us and one of our knowledgeable Customer Service Associates will be happy to help you.

See more on our Shipping Policy.

Top of Page

My Order Didn't Arrive

Orders shipped through our Priority and Express shipping options can be tracked on our shipping carriers' Web sites. If you wish to track an order, go to Track Your Orders. We're sorry, but orders shipped by the Standard option cannot be tracked door to door. If you still have questions about an order that has not arrived, please contact us and one of our knowledgeable Customer Service Associates will be happy to help you.

See more on our Shipping Times.

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An Item Is Damaged or Defective

We are committed to your total shopping satisfaction. If an item you receive from .com does not meet your expectations, simply return it to us. Most merchandise can be returned to a store or by mail within 90 days of delivery. See our Returns Policy for exceptions.

Gift wrapping charges (if any) are not refundable. Shipping charges are not refundable except if you were sent an incorrect, damaged or defective product.

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Do you have questions?
Please contact us, and a knowledgeable Customer Service Associate will help you.
We're happy to serve you 24 hours a day, 7 days a week!

Returns Policy

Your complete shopping satisfaction is our number one priority.

If an item you ordered from .com does not meet your expectations, simply return it either to a store or by mail within 90 days of receiving it, unless otherwise noted below.

To Return an Item to a Store
Returns Guidelines by Department
Returns Exceptions
Credit for Gift Returns
Exchanges

To Return an Item to a Store

- Take the item, invoice and all original packaging and accessories to Customer Service at your local .
- For all payment methods except Bill Me Later®, an associate will issue an immediate credit to the original payment method or provide a store credit for the cost of the item and the sales tax, if applicable.
- For an item paid for with Bill Me Later, an associate can issue store credit in the form of a Shopping Card or a cash refund. Then you receive a bill from Bill Me Later and submit payment to Bill Me Later.

Return an Item by Mail

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Returns Guidelines by Department

All merchandise purchased from .com may be returned either to a store or by mail within 90 days of receiving it, unless otherwise noted below. Additional guidelines are also noted below.

APPAREL, SHOES & ACCESSORIES

- All apparel, shoes and accessories items: 90 days with receipt and merchandise must be unworn, with tickets attached, and accompanied by the original pack list/invoice.

BOOKS, MOVIES & VIDEO GAMES

- CDs, DVDs, audiotapes, videotapes and video games: Must be returned unopened.
- Books: Must be returned unused and unmarked.

ELECTRONICS

More Help: Shipping
Go to Help main page
Go to Shipping and Re
main page

Related Topics
Problems With Your O

Find a Stor
Enter ZIP code to find a store near you.
ZIP Code:
Find

- **Computer hardware:** Must be returned with any included software within 15 days of receipt.
- **Computer components and computer accessories:** Must be returned within 45 days of receipt.
- **Computer software:** Must be returned unopened.
- **Camcorders and digital cameras:** Must be returned within 30 days of receipt.

GIFTS

- **Electronic and plastic gift cards:** Not returnable or refundable for cash, except in states where required by law.
- **Perishables:** Items such as flowers and food may be returned to a store or by calling Customer Service at 1-800-966-6546. Cannot be returned by mail.

HOME & GARDEN

- **Custom window blinds:** Please see returns for window blinds.
- **Mattresses:** May be returned to a store or by Freight shipping. Under some circumstances, you may be charged for return shipping. To return an item by Freight, call Customer Service at 1-800-966-6546. They will also be able to inform you of any return shipping costs.
- **Gas-powered items:** Including but not limited to lawn mowers and pressure washers. Cannot be returned by mail, due to carrier restrictions. Must be returned to a store completely emptied of any flammable liquid (gas, oil).

MUSIC

- **CDs and DVDs:** Must be returned unopened.
- **Music downloads:** Cannot be returned. All sales are final and all charges from those sales are nonrefundable, except as otherwise stated in the Music Downloads Terms of Service.

PHARMACY

- **Diabetic supplies:** Cannot be returned. All sales are final. Please contact the manufacturer if you have any questions regarding defective items. Check your package for the manufacturer's name and contact information.

TIRES

- **Tires:** Tires shipped to a store for pick-up must be returned to a store and cannot be returned or exchanged by mail.

TOYS, SPORTS & FITNESS

- **Oversize table games and treadmills:** May be returned to a store or by Freight shipping. Under some circumstances, you may be charged for return shipping. To return an item by Freight, call Customer Service at 1-800-966-6546. They will also be able to inform you of any return shipping costs.
- **Autographed Sports Memorabilia:** Must be returned with the included Certificate of Authenticity.

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Returns Exceptions

- **Oversize items:** Some heavy or large items that are identified as oversize on their item pages may be returned to a store or by Freight shipping. Under some circumstances, you may be charged for return shipping. To return an item by

Freight, call Customer Service at 1-800-966-6546. They will also be able to inform you of any return shipping costs.

- If you were sent an incorrect, damaged or defective product, we will issue a credit for any applicable shipping and gift-wrapping charges.

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Credit for Gift Returns

- Returning a gift to a store: An Associate will issue an immediate credit to the original payment method or provide a store credit for the cost of the item and the sales tax, if applicable.
- Returning a gift by mail: The cost of the item and the sales tax, if applicable, will be credited to the original payment method when we receive the item.

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Exchanges

To exchange an item by mail, fill out "Items to Be Exchanged" on the back of our invoice, indicating the item you are returning and the new item(s) you want sent. Please be as specific as possible when describing the new item. For example, give the item name, color, size, and so on. Then enclose the invoice with your return.

The item returned will be credited to the original payment method and the new item(s) will be charged to the same payment method. Shipping charges for the returned item are not refundable. Shipping will be charged for the new item(s) sent.

A gift you received is not exchangeable by mail. If you return a gift by mail, the cost of the item and the sales tax, if applicable, will be credited to the original payment method when we receive the item.

Top of Page

Do you have questions?
Please contact us, and a knowledgeable Customer Service Associate will help you.
We're happy to serve you 24 hours a day, 7 days a week!

Continue shopping on .com

Get the Wire Email, with the latest Rollbacks & savings. Sign Up Learn more abo other newsletters

Your email address will never be sold to a third party. See our Privacy Policy.

(6)

WWW.

Shipment Summary

Ordered by:
Sandra Heuer
6669 Giannini ct.
Castro Valley, CA 94552
USA

Received by:
Sandra Heuer
2551 San Ramon Valley Bl. #207
San Ramon, CA 94583
USA

SHIPMENT DATE	SHIPPED VIA	TRACKING #	ORDER #
09/06/02			2677025176353

			Unit Price	Amount
1	9738338284	Jimmy Neutron	$19.95	$19.95
			Subtotal	$19.95
			Shipping	6.88
			Tax	1.64
			Total	$28.47

TC# 09004721631020292781627 6 UCC# 20020906-055858-284-091

Thank you for shopping at .com!

Didn't receive your entire order?
You may receive your order in separate shipments. If your entire order did not arrive in this shipment, you can track the status of your order at www. .com/tracking.

Questions about your order?
Call us at 1-800-966-6546, or visit our Web site at www. .com. We're happy to answer your questions, and we're committed to making your shopping experience easy and pleasant

Want to make a return?
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PERSONAL

Born November 20, 1968; married, 1 child; U.S. citizen

EDUCATION

Ph.D. (Economics), Indiana University, August 2003
M.A. (Economics), Indiana University, December 2000
B.A. (Economics), Michigan State University, December 1992

DISSERTATION

Title: "The Economics of Retail Pricing on the Internet"

FIELDS OF RESEARCH

Industrial Organization, Game Theory and Strategy, and Applied Econometrics

PUBLICATIONS & ACADEMIC RESEARCH

PUBLISHED & FORTHCOMING PAPERS

- "A Review of Three Directed Acyclic Graphs Software Packages: MIM, Tetrad, and WinMine." (with Dominique Haughton and Arnold Kamis), *The American Statistician*, August 2006, 60(3), 272-286.

- "Information, Search and Price Dispersion" (with Michael R. Baye and John Morgan) in Handbook on Economics and Information Systems (T.J. Hendershott, Ed.), Amsterdam: Elsevier, forthcoming.

- "Temporal Price Dispersion: Evidence from Shopper.com" (with Michael R. Baye and John Morgan), *Journal of Interactive Marketing*, Autumn 2004, 18 (4), 101-115.

- "Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site" (with Michael R. Baye and John Morgan), *Journal of Industrial*

BRS-00266

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

MAY 30, 2012

---oOo---

PUBLIC HEARINGS

F1 PROPOSED ADOPTION OF AMENDMENTS TO REGULATION 1684,

COLLECTION OF USE TAX BY RETAILERS

---oOo---

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

Electronically signed by Kathleen Skidgel (601-100-826-6264) 4a631582-535a-4a00-8c80-d7fe57a5d335

1 P R E S E N T

2

3 For the Board of Equalization: Jerome E. Horton
Chairman

4

5 Michelle Steel
Vice-Chairwoman

6

7 Betty T. Yee
Member

8

9 George Runner
Member

10

11 Marcy Jo Mandel
Appearing for John
12 Chiang, State Controller
(per Government Code
13 Section 7.9)

14

Joann Richmond
15 Chief
Board Proceedings Division

16

17 ---oOo---

18 For Staff: Bradley Heller
Tax Counsel IV
19 Tax and Fee Division
Legal Department

20

21 ---oOo---

22 Speakers: Fran Mancia

23 Al Koch

24 ---oOo---

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1 INDEX OF SPEAKERS

NAME	PAGE
Fran Mancia	7
Al Koch	8

---oOo---

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 MAY 30, 2012
4 ---oOo---
5 MR. HORTON: Ms. Richmond, next item.
6 MS. RICHMOND: Our next item is F, Public
7 Hearings.
8 Our first public hearing is F1, Proposed
9 Adoption of Amendments to Regulation 1684, Collection of
10 Use Tax by Retailers.
11 MR. HORTON: Okay.
12 Members, Mr. Brad Heller, the tax counsel,
13 will, uh, report out on this matter.
14 Prior to reporting, I would just ask that,
15 uh -- we have several witnesses. I would ask that they
16 come forward, uh, and have a seat at the --
17 Mr. Alberto Torrico, attorney for the City of
18 Fillmore --
19 MR. RUNNER: Not on this one.
20 MS. MANDEL: That'd be for this one?
21 MR. HORTON: Oh. Oops. Oops. Sorry. Okay.
22 Not for this one. All right.
23 Mr. Heller, it's all in your hands.
24 MR. HELLER: Perfect. Thank you, Mr. Horton,
25 or Chairman Horton.
26 Uh, I'm Bradley Heller from the Board's Legal
27 Department, as you mentioned. And I'm here to request
28 that the Board adopt the proposed amendments to

1 Regulation 1684, Collection of Use Tax by Retailers.
2 MR. HORTON: Okay.
3 MR. HELLER: Uh, the proposed amendments make
4 the regulation consistent with --
5 MR. HORTON: Thank you.
6 MR. HELLER: -- further clarify and implement
7 the amendments made to the definition of retailer
8 engaged in business in California by Assembly Bill 155.
9 Um, in addition -- or I should -- in addition,
10 I just wanted to mention that, uh, the notice -- uh, the
11 notice of proposed rulemaking has a typographical error
12 that indicates that the Board, uh -- the Board approved
13 a publication of the proposed amendments during a BTC
14 meeting in, uh, February 28th, 2011, and it should have
15 said "2012."
16 The date is correct in the initial Statement of
17 Reasons, and we've posted a notice of correction on the
18 Board's website. And we are -- I'm noting it for the
19 record as well today. And we've contacted OAL and we
20 understand we can go ahead and adopt the amendments if
21 the Board, uh, approves them today.
22 I can also answer any questions you may have or
23 respond to any public comments, if you --
24 MS. STEEL: Just quick question.
25 Um, so one-time certification, or it's going to
26 be annual certification?
27 MR. HELLER: The -- for the, uh -- the contract
28 clause?

1 MS. STEEL: Right.
2 MR. HELLER: I believe that's an annual
3 certification.
4 MS. STEEL: So every time I --
5 MR. HELLER: I have to go check. Let me make
6 sure.
7 MS. STEEL: Because last time when you came
8 that I requested to review that.
9 MR. HELLER: It would be -- let's see.
10 MR. HORTON: Oh, okay.
11 MR. HELLER: Yeah, it's an annual
12 certification.
13 MS. STEEL: So they have to come back every
14 year to get it.
15 MR. HELLER: Correct. And I believe, as I
16 mentioned during the Business Taxes Committee meeting,
17 the idea was so that -- to require the retailers to
18 actually check on the people who might be soliciting
19 business on their behalf in California on an annual
20 basis, as opposed to just setting a contract in motion
21 and never having to check on those, uh, activities ever
22 again.
23 MS. STEEL: Okay. Just, can you tell me one
24 more time?
25 MR. HELLER: Oh, sure. Let me reclarify.
26 MS. STEEL: When they do -- okay.
27 MR. HELLER: If it was just one
28 certification --

1 MS. STEEL: Mm-hmm.
2 MR. HELLER: -- then basically once there's a
3 certification, the retailer would never have to check on
4 any activities of the person who is -- who did that
5 certification ever again.
6 So let's pretend I have you give me a
7 certification the minute we sign the contract. Well,
8 then I never have to check on the activities that you
9 actually are doing ever again.
10 MS. STEEL: Okay.
11 MR. HELLER: I could just rely on that
12 certificate.
13 MS. STEEL: Got it. Got it. Okay.
14 MR. HELLER: Perfect.
15 MR. HORTON: Okay. I ask that the witnesses
16 introduce themselves for the record, and then, uh, make
17 your presentation.
18 ---oOo---
19 FRAN MANCIA
20 ---oOo---
21 MR. MANCIA: Thank you, Mr. Chairman and
22 Members. My name's Fran Mancia. I'm with MuniServices.
23 Um, I'd like to thank you for the opportunity
24 to be here today. And I'm pleased to express our
25 support to the amendments that are before you today, uh,
26 for adoption.
27 We are -- had the pleasure of being a part of
28 the interested party process throughout. And, uh, I

1 thought it was a very positive and collaborative effort.
2 Uh, MuniServices has worked with local
3 governments for over 30 years and we've always
4 encouraged and supported efforts related to the
5 collection and remittance of use taxes that are owed.
6 And we also supported AB 155 during the legislative
7 process.
8 So, again, I just want to thank you and, in
9 closing, support the efforts to encourage the adoption
10 of these amendments.
11 Thank you.
12 MR. HORTON: Thank you very much.
13 Mr. Koch, will you please introduce yourself
14 for the record.
15 ---oOo---
16 AL KOCH
17 ---oOo---
18 MR. KOCH: Uh, yes, Mr. Chairman. Thank you.
19 My name is Al Koch, um, and I'm appearing here
20 today as a tax attorney and member of the public.
21 I thank you for the opportunity to appear and
22 to comment on, uh, the proposed amendments to Regulation
23 1684 which I support fully.
24 Staff has done an outstanding job in preparing
25 to implement difficult and very important legislation,
26 AB 155. I applaud their outstanding effort in this
27 regard. It's complicated work and, uh, I think they've,
28 uh -- they've done yeoman work. I apologize for not

1 having been involved in the interested party proceedings
2 earlier, but I have been otherwise occupied.
3 Notwithstanding my approval of the draft, I
4 suggest that it could be improved somewhat, uh, if the
5 Board Members would give serious consideration to adding
6 a sentence at the end of proposed subdivision (b)(3) of
7 Regulation 1684 to read as follows:
8 "A retailer will be regarded as having a
9 physical presence in California if it makes
10 substantial sales to California purchasers that
11 constitute sales on approval, within the
12 meaning of Regulation 1628 (b)(3)(C)."
13 And that's an existing regulation that's been
14 enforced for many years.
15 Regulation 1628(b)(3)(C) states:
16 "When the sale is on approval, the sale
17 does not occur until the purchaser accepts the
18 property."
19 Thus, the retailer still owns the property
20 until the purchaser accepts it. Thus, if the property
21 is shipped from out of state by a remote seller, uh, in
22 a sale on approval, the remote seller still owns it when
23 it is delivered in California. For a large retailer,
24 this could create substantial nexus.
25 Now, the addition of the proposed language does
26 not purport to decide that anyone is making or has made
27 sales on approval. Uh, it leaves that issue open for
28 decision by the administrator in the first instance.

Electronically signed by Kathleen Skidgel (601-100-826-6264) 4a631582-535a-4a00-8c80-d7fe57a5d335

1 Uh, now I did attach some materials to a letter
2 that I forwarded to you yesterday in which the Attorney
3 General took the position that remote sellers were
4 making, uh, sales on approval in litigation that took
5 place in 1991. Uh, I can go over those materials if you
6 would like me to, but I don't want to take any more
7 time, uh, than is necessary because I know you have more
8 things to do today.
9 I should also disclose that there has been
10 recent litigation on what is a sale on approval, uh,
11 that was before the SBE in a local tax misallocation
12 case in 2007. That case is pending in the San Francisco
13 Superior Court. But my understanding is, uh, that in
14 its current posture, the proposed, uh, statement of
15 decision issued by the judge in that case, uh, has
16 declined to rule on that issue one way or the other.
17 So it's not really currently, uh, an active --
18 an active matter. And in addition, in that case, uh,
19 the taxpayer that was in the jurisdiction that's
20 involved in that case has moved. So there would be no
21 prospective impact, uh, from -- from the prospective,
22 uh, regulation that you're considering today.
23 If you have any questions, I'd be happy to
24 answer them.
25 MR. HORTON: Uh, Members, I'm going to ask
26 Mr. Heller to respond, uh, share his thoughts in that
27 regard.
28 MR. HELLER: Thank you, Chairman Horton.

1 Um, staff has looked at, uh, Mr. Koch's
2 comments and all of the background material that he
3 submitted yesterday. And, essentially, we just -- we
4 don't believe that the additional amendments are
5 necessary. And the first reason is that we don't
6 believe that there are -- there is a considerable amount
7 of sales on approval being made. And that part of that
8 may have to deal with our differing interpretations of
9 what exactly is a sale on approval.
10 But, in general, uh, the Legal Department does
11 not believe there's extensive amount of sales on
12 approval and that may be a very minimal amount of sales
13 on approval. Because it's essentially the situation
14 where the retailer truly ships the property to the
15 customer where, if it's not a completed sale until the
16 customer agrees that everything meets their
17 specifications or -- to put it loosely, and, um,
18 essentially that's just not a common business practice.
19 Uh, the second issue is, essentially, the way
20 that the -- the way that the presumption's written in --
21 in the current, uh, proposed amendments, it just applies
22 to everyone with a physical presence. So by doing this,
23 we would really be saying that the presumption
24 automatically applies to everyone who does a sale on
25 approval and, therefore, indicating that we think that
26 those -- those, uh, retailers have a substantial nexus
27 with California and are required to register to collect
28 use tax.

1 And my understanding is, is that the Legal
2 Department does not agree that a person who just makes a
3 sale on approval is necessarily has substantial nexus
4 with the State of California and is required to
5 register.
6 So we're not really sure that this -- these
7 amendments would really clarify the regulation in a way
8 that would really help retailers or the Board's
9 administration of the regulation. And, essentially, if
10 a retailer has a physical presence, then the presumption
11 already applies and we can reach the issue of whether or
12 not a, uh -- a sale on approval, should it exist,
13 creates a physical presence at another time.
14 MR. HORTON: Thank you.
15 Discussion, Members?
16 MR. KOCH: Could I make one response?
17 MR. HORTON: Um --
18 MR. KOCH: Very short.
19 MR. HORTON: Sir, I would end up in a colloquy.
20 So I'd rather --
21 MR. KOCH: Okay. Thank you.
22 MR. HORTON: Um, is there a motion, Members?
23 MS. YEE: Um, move to adopt the, uh, regulation
24 as amended -- I mean, the amendments to 1684.
25 MR. HORTON: Moved by Member Yee to adopt the,
26 uh, staff recommendations --
27 MS. YEE: Yes.
28 MR. HORTON: -- of the amendments as

1 recommended.

2 Second by Member Steel.

3 Without objection, Members, such will be the

4 order.

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1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, KATHLEEN SKIDGEL, Hearing Reporter for the

8 California State Board of Equalization certify that on

9 May 30, 2012 I recorded verbatim, in shorthand, to the

10 best of my ability, the proceedings in the

11 above-entitled hearing; that I transcribed the shorthand

12 writing into typewriting; and that the preceding pages 1

13 through 13 constitute a complete and accurate

14 transcription of the shorthand writing.

15

16 Dated: June 7, 2012

17

18 Kathleen Skidgel

19

20 KATHLEEN SKIDGEL, CSR #9039

21 Hearing Reporter

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Action: Upon motion of Mr. Runner, seconded by Ms. Mandel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board ordered that the petition be submitted for decision, granting the petitioner 30 days to file supporting documents, the Department 30 days to respond, and the Appeals Division 30 days thereafter to review the parties' submissions and provide its recommendation to the Board.

Ms. Steel requested staff to review the call log for discussions with Mr. Bonacich regarding a fax of his disagreement with the notice of determination.

Ms. Steel requested staff to review the tax collection procedures and bank account levies, and report to the Customer Services and Administrative Efficiency Committee for discussion.

PUBLIC HEARINGS

F1 Proposed Adoption of Amendments to Regulation 1668, Collection of Use Tax by Retailers

Bradley Heller, Tax Counsel, Legal Department made introductory remarks regarding proposed adoption of amendments which incorporate and implement changes to the definition of "retailer engaged in business in this state" made by Assembly Bill No. 155(Stats. 2011, ch. 313) (Exhibit 5.2).

Speakers: Fran Mancia, MuniServices
Al Koch, Law Offices of Albin C. Koch

Action: Upon motion of Ms. Yee, seconded by Ms. Steel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board adopted the proposed amendments to regulation 1684 as recommended by staff.

F2 Timber Harvest Values

David Yeung, Principal Property Appraiser, Property and Special Taxes Department, made introductory remarks that on or before June 30, 2012, the Board shall estimate the immediate harvest values of and adopt schedules for each species or sub-classification of timber harvested between July 1 and December 31, 2012. Revenue and Taxation Code section 38204(a) (Exhibit 5.3).

Speakers were invited to address the Board, but there were none.

Action: Upon motion of Ms. Yee, seconded by Mr. Runner and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board approved the timber harvest values schedules as recommended by staff.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Executive Director

April 6, 2012

To Interested Parties:

Notice of Proposed Regulatory Action
by the
State Board of Equalization

Proposed to Adopt Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*. Regulation 1684 implements, interprets, and makes specific the provisions of RTC sections 6203 and 6226, which collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers, and RTC section 6204, which makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. The proposed amendments make the regulation consistent with, further clarify, and implement the amendments made to RTC section 6203 by Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313.), which changed the definition of "retailer engaged in business in this state."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 30 - 31, 2012. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on May 30 or 31, 2012. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1684.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6203.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing Federal Law Regarding the Collection of State Use Tax

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Further, the United States Supreme Court has historically agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales

of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

In addition, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556); and the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.) (The initial statement of reasons contains a more detailed discussion of federal and state case law regarding substantial nexus.)

Current California Law Regarding the Collection of Use Tax

Currently, RTC sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers. Also, RTC section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203. Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board, as required.

Currently, the operative provisions of RTC section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e), provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in RTC section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Currently, Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e), regarding convention and tradeshow activities.

RTC Section 6203 as Amended by AB 155

RTC section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

RTC section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group," as defined in RTC section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulation 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to RTC section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to RTC section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in

this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to RTC section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

The amendments made to RTC section 6203 by AB 155 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. If a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1684

Board staff conducted meetings with interested parties on October 31 and December 20, 2011, in Sacramento, California, and November 2 and December 22, 2011, in Culver City, California, to discuss the effect of the amendments made to RTC section 6203 by AB 155 and how to best amend Regulation 1684 to make it consistent with the amendments to section 6203, implement the new provisions that were added to RTC section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that AB 155 will require retailers to register to collect California use tax if they have a "substantial nexus" with California.

After discussing AB 155 with the interested parties and reviewing the interested parties' comments, Board staff recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of RTC section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise";
- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within

the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California;

- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5), by utilizing contractual terms and factual certifications; and expressly excuse retailers from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Define the term "person" by reference to the definition of "person" set forth in RTC section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.) The proposed amendments are anticipated to provide the following specific benefits:

- Ensure that Regulation 1684 is consistent with the amendments made to section 6203 by AB 155 when the amendments made to section 6203 become operative;

- Ensure that the amendments made to section 6203 by AB 155 are interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Scripto*, and *National Geographic Society*;
- Ensure that section 6203's new affiliate nexus provisions will be interpreted and administered consistently;
- Provide guidance to retailers as to whether their activities create a "substantial nexus" with California and require them to register with the Board to collect use tax; and
- Provide more certainty to retailers regarding their new use tax collection obligations before the amendments made to section 6203 by AB 155 becomes operative.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1684 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1684 is the only state regulation prescribing retailers' obligations to collect California use tax. In addition, there is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1684.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1684 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The adoption of the proposed amendments to Regulation 1684 will making Regulation 1684 consistent with the amendments to RTC section 6203 made by AB 155, clarify and implement the new provisions that were added to section 6203 by AB 155 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and provide notice to retailers that section 6203 will require retailers to register to collect California use tax if they have a

"substantial nexus" with California once the amendments made by AB 155 become operative. The proposed amendments will not impose any new taxes or expand any retailers' use tax collection obligation beyond that imposed by section 6203 as amended by AB 155. Therefore, the Board has made an initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1684 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1684 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at

Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on May 30, 2012, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1684 during the May 30 - 31, 2012, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1684. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1684 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

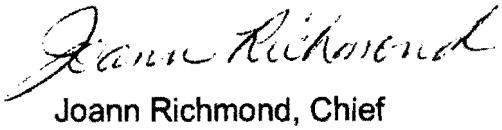
The Board may adopt the proposed amendments to Regulation 1684 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting

amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1684, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:reb

Initial Statement of Reasons

Adoption of Proposed Amendments to California Code of Regulations, Title 18, Section 1684, *Collection of Use Tax by Retailers*

SPECIFIC PURPOSE AND NECESSITY

Current Regulation 1684 and Current Section 6203

California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*, requires "[r]etailers engaged in business in this state as defined in Section 6203" of the Revenue and Taxation Code (section[1] 6203) to register with the State Board of Equalization (Board), collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board.

Current Provisions of Section 6203
Currently, the operative provisions of section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "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.
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state. (Current section 6203, subd. (c)(1)-(3).)

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a

[1] All further section references are to the Revenue and Taxation Code, unless otherwise indicated.

> computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e) provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Current Provisions of Regulation 1684
Currently, Regulation 1684 does not define the full scope of the phrase "retailer engaged in business in this state," as defined in section 6203. Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of the phrase "retailer engaged in business in this state," as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e) regarding convention and tradeshow activities.

Section 6203 as Amended by Assembly Bill No. 155

Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313) was enacted on September 23, 2011, and section 3 of AB 155 will amend the definition of "retailer engaged in business in this state," as set forth in current section 6203. Section 6 of AB 155 provides that the amendments made to section 6203 will become operative on September 15, 2012, if a federal law is not enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller. However, if a federal law is enacted on or before July 31, 2012, authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller, and the state does not, on or before September 14, 2012, elect to implement that law, the amendments made to section 6203 by AB 155 will become operative on January 1, 2013.

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

Section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group" as defined in section 25105, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in Regulations 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to section 6203 by AB 155 will also repeal the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

Substantial Nexus

Physical Presence Test

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id.* at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing

state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id.* at pp. 317-318); and

- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id.* at p. 315).

Historically, the United States Supreme Court has agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id.* at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connection with a taxing state by organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id.* at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid.*; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society, supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

Further, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society, supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society, supra*, 430 U.S. at p. 556). Subsequently, the United States Supreme Court held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill, supra*, 504 U.S. at p. 315, fn. 8.)

More recently, the Court of Appeals of New York (i.e., New York's highest appellate court) explained that, while the "physical presence" test affirmed in *Quill* requires that a retailer have more than the slightest physical presence in a state before that state can require the retailer to collect the state's use tax, the physical presence "does not need to

be substantial" and "it may be manifested by the presence in the taxing State of the [retailer's] property or the conduct of economic activities in the taxing State performed by the [retailer's] personnel or on its behalf." (*Orvis Co., Inc., v. Tax Appeals Tribunal of the State of New York et al.* (1995) 86 N.Y.2d 165, 178.) Furthermore, the California Court of Appeal expressly agreed with and followed the Court of Appeals of New York's construction of the physical presence test in *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179, 1198-1199. And, the California Court of Appeal further explained that activities performed in California by or on behalf of a retailer will be sufficient to satisfy the physical presence test if they enhance the retailer's sales to California customers and significantly contribute to the retailer's ability to establish and maintain a market in California. (*Id.* at p. 1196.)

Commonly Controlled Group Nexus
The Board is aware that, in *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, the California Court of Appeal held that an out-of-state corporate retailer with no stores, solicitors, or property within California does not have a physical presence in California solely because it is acquired by another corporation that is a retailer with a physical presence. However, in that case, the California retailer's activities did not give the out-of-state retailer a physical presence in California because:

- Neither entity was the alter ego or agent of the other for any purpose;
- Neither entity solicited orders for the products of the other, and neither accepted returns of the merchandise of the other or otherwise assisted or provided services for customers of the other;
- Each entity owned, operated, and maintained its own business assets, conducted its own business transactions, hired and paid its own employees, and maintained its own accounts and records;
- Neither entity held itself out to customers or potential customers as being the same as, or an affiliate of, the other;
- Each entity had its own trade name, goodwill, marketing practices and customer lists and marketed its products independently of the other; and
- Neither purchased goods or services from the other. (*Id.* at p. 388.)

The Board does not believe that the holding in *Current* affects the validity of the new commonly controlled group nexus provisions of section 6203, subdivision (c)(4), that will become operative on September 15, 2012, or January 1, 2013, which provide that a retailer is engaged in business in California if: (1) the retailer is a member of a commonly controlled group, as defined in section 25105; and (2) the retailer is a member of a combined reporting group, as defined in Franchise Tax Board Regulation 25106.5, subdivision (b)(3), that includes "another member of the retailer's commonly controlled group that, ***pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer***, including, but not limited to, design and development of tangible personal

property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer." (Emphasis added.)

This is because the United States Supreme Court agreed with the Washington Supreme Court, in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, 250-251, that a retailer has a substantial nexus with a taxing state if there are persons in that state performing activities on behalf of the retailer that enable the retailer to "establish and maintain a market." Additionally, in 2005, the California Court of Appeal subsequently quoted *Tyler Pipe* before concluding that an out-of-state retailer organized as a limited liability company (LLC) had a substantial nexus with California because a separate corporation, affiliated with the LLC through a common parent, performed activities in California on behalf of the retailer that were significantly associated with the retailer's ability to establish and maintain its California market. (*Borders Online*, *supra*, 129 Cal.App.4th at pp. 1196, 1197.) Accordingly, the Board believes that the California Court of Appeal's holding in *Current* would have been different if the in-state corporation had performed services in California in connection with tangible personal property to be sold by the out-of-state corporation, pursuant to an agreement with or in cooperation with the out-of-state corporation (i.e., if the provisions of section 6203, subdivision (c)(4) (emphasized above) had been operative and satisfied in that case).

Affiliate Nexus

The State of New York has enacted an affiliate nexus statute that is similar to the provisions of section 6203, subdivision (c)(5), as add by AB 155. The New York statute creates a rebuttable presumption that a retailer is soliciting business in New York through an independent contractor or other representative and is required to register to collect New York use tax if the retailer enters into an agreement with a resident of New York under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the retailer's cumulative gross receipts from sales to customers in New York who were referred to the retailer by residents with the requisite agreements is in excess of $10,000 during the four proceeding quarters. (N.Y. Tax Law § 1101, subd. (b)(8)(vi).) The New York statute also provides that the presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer "that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question." (*Ibid.*)

Amazon.com LLC filed a lawsuit in New York seeking declaratory and injunctive relief on the ground that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; however, when the Supreme Court of New York County (i.e., a New York trial court) denied the relief, Amazon.com LLC dropped its facial challenge and appealed the trial court's decision on other grounds, including the ground that the New York statute allegedly violates the Commerce Clause as applied to Amazon.com LLC. (*Amazon.com, LLC, et al. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.) Overstock.com, Inc. also filed a lawsuit in New York seeking injunctive and declaratory relief on the ground

that that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; and when the Supreme Court of New York County denied the relief, Overstock.com, Inc. argued that the statute allegedly violates the Commerce Clause both on its face and as applied to Overstock, Inc. when it appealed the Supreme Court of New York County's decision. (*Overstock.com, Inc. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.)

Amazon.com, LLC's and Overstock.com, Inc.'s appeals were consolidated into one matter before the Appellate Division of the Court of Appeals of New York (i.e., an intermediate appellate court) and jointly decided on November 4, 2010. (2010 N.Y. Slip Opn. 7823.) In that decision, the Appellate Division denied Overstock.com, Inc.'s facial challenge because the court concluded that the New York statute is consistent with the "physical presence" test, which was affirmed in *Quill* and discussed at length in *Orvis*, in that the New York statute only requires a retailer to register to collect New York use tax if the retailer enters into a business-referral agreement with a New York resident, the resident actively solicits business in New York, as opposed to merely posting a passive advertisement, and the resident receives a commission based upon the sales successfully solicited in New York. (2010 N.Y. Slip Opn. 7823, at pp. 8-10.) However, the Appellate Division remanded the as-applied challenges back to the trial court for discovery.

The Board believes that, after remand back to the trial court for further factual development, both Amazon.com, LLC and Overstock.com, Inc. may continue to press their objections to the Appellate Division's decision to the Court of Appeals of New York (i.e., New York's highest appellate court). However, in the meantime, the New York State Department of Taxation and Finance has issued Technical Services Bureau Memorandum TSB-M-08(3)S (May 8, 2008), which explains the rebuttable presumption in the New York statute and provides that the "Tax Department will deem the presumption rebutted where the [retailer] is able to establish that the only activity of its resident representatives in New York State on behalf of the [retailer] is a link provided on the representatives' Web sites to the [retailer's] Web site and none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the [retailer]." And, TSB-M-08(3)S further provides that "an agreement to place an advertisement does not give rise to the presumption"; however, "placing an advertisement does not include the placement of a link on a Web site that, directly or indirectly, links to the Web site of a [retailer], where the consideration for placing the link on the Web site is based on the volume of completed sales generated by the link."

The New York State Department of Taxation and Finance also issued Technical Services Bureau Memorandum TSB-M-08(3.1)S (June 30, 2008), which provides that a retailer may rebut the presumption that it has nexus under the New York statute by meeting both of the following conditions:

1. Contract condition – Showing that the contract or agreement between the retailer and the resident representative provides that the resident representative is prohibited from engaging in any solicitation activities in New York that refer potential customers to

the retailer, including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails, and, if the resident representative is an organization (such as a club or a nonprofit group), showing that the contract or agreement also provides that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above; and

2. Proof of compliance condition – Showing that each resident representative has submitted to the retailer, on an annual basis, a signed certification stating that the resident representative has not engaged in any prohibited solicitation activities in New York, as described above, at any time during the previous year, and, if the resident representative is an organization, that the annual certification also include a statement from the resident organization certifying that its Web site includes information directed at its members alerting them to the prohibition against each of the solicitation activities described above.

However, as to the proof of compliance condition, a signed certification from a resident representative may only be used to rebut the presumption in the New York statute if the retailer accepts it in good faith (i.e., the retailer does not know or have reason to know that the certificate is false or fraudulent).

In addition, the Board is aware that subdivision (a)(1) of Regulation 1540, *Advertising Agencies and Commercial Artists*, provides that: "Advertising is commercial communication utilizing one or more forms of communication (such as television, print, billboards, or the Internet) from or on behalf of an identified person to an intended target audience." The Board is also aware that, in the administrative appeal of Barnes & Noble.com, LLC, the Board had to determine whether certain in-state activity constituted "advertising" or "selling." In the Memorandum Opinion the Board adopted to decide the Barnes & Noble.com appeal, the Board stated that "an 'advertisement' is a 'written, verbal, pictorial, graphic, etc., announcement of goods or services for sale, employing purchased space or time in print or electronic media.'" However, the Board also concluded that when California employees of Barnes & Noble Booksellers, Inc. (B&N Booksellers), physically distributed coupons to B&N Booksellers' customers, which could only be used to make discounted purchases from Barnes & Noble.com (B&N.com), the acts of physically distributing the coupons directly to the potential customers of B&N.com were solicitations of those persons, and went beyond mere advertising to the public at large. (Memorandum Opinion, *Barnes & Noble.com*, adopted September 12, 2002.)

Furthermore, the Board is aware that Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) provides that the word "advertise" means "[t]o make known to the public through a medium of publicity that one's goods or services are available for sale or engagement." In addition, Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) defines the word "solicit" as "to invite a business transaction" or "[t]o importune, entreat, implore, ask, attempt, or try to obtain an order" and defines the phrase "solicitation of business" as "seeking orders for goods or services."

Adoption of Regulation 1684's Current Website Provisions
The Board adopted the current provisions of Regulation 1684, subdivision (a), regarding computer servers, websites, and Internet service providers on September 10, 1997. The Final Statement of Reasons for the adoption of the provisions provides that:

> In recent years, two business practices have arisen which raise the issue as to whether or not the retailers practicing them thus became engaged in business in this state. First, some out-of-state retailers have established Web Sites (electronic files maintained on computers called servers) on the World Wide Web, part of the Internet, for the purpose of making sales. The Internet evolved from a Defense Department project in the late 1960's, and has grown to be a world-spanning network of at least 60,000 smaller, independent computer networks linked by satellites, coaxial cable, and phone lines. The World Wide Web is a smaller network of hyperlinked documents within the Internet. (Yahoo! Internet Life (8/97), p. 62) Servers mainly belong to service providers, either Independent Service Providers (ISP's), or national commercial on-line services like Prodigy or America On-Line. The server on which the Web Site is located may or may not be sited in California. Confusion has arisen as to whether or not an in-state ISP who hosts an out-of-state retailer's Web Site is a "representative" within the meaning of Section 6203(b) for use tax collection purposes and, if so, whether the exemption contained in Section 6203(j), whereby nexus is not provided by a retailer's use of an on-line service for the purpose of taking orders for tangible personal property if the primary purpose of the service is not the sale of tangible personal property, applies to a retailer's Web Site carried by a general-interest ISP which hosts a myriad of Web Sites as well as to a proprietary on-line service. Legislation has been introduced to clarify these principles, but none has yet been enacted. As more and more business is being conducted on the Internet, the Board concluded that it was necessary to resolve this issue by regulation to bring some certainty to this area pending legislative action. Upon consultation with industry, the Board concluded that a Web Site is a utility service operating through communications lines to forward a buyer's order to the retailer, so that orders placed through a Web Site should be treated for nexus purposes like orders placed through the mail which the United States Supreme Court has determined does not provide "nexus." (Quill Corporation v. North Dakota (1992) 504 U.S. 298.) The Board also concluded that the Legislature did intend that Section 6302(j) apply to Web Sites hosted by ISP's as well as to proprietary networks.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a), regarding the use of computer servers, websites, and Internet service providers was based upon the Board's 1997 interpretation of *Quill* and not solely the express language of subdivision (d) of current section 6203, which will be inoperative on September 15, 2012, or January 1, 2013, due to the provisions of AB 155. However, the

Board's Legal Department's current opinion is that an out-of-state retailer that owns a computer server in California (as opposed to merely purchasing web services through a third party's servers) has a place of business in California where the server is located and is, thus, obligated to collect California use tax, under the current (and continuing) provisions of section 6203, subdivision (c)(1).

Warranty and Repair Services
The Board adopted the current provisions of Regulation 1684, subdivision (a), regarding warranty and repair services on September 10, 1997. The Final Statement of Reasons for the adoption of the provisions provides that:

> [M]any retailers have entered into contracts with instate businesses to perform repair services on such retailers' products purchased by buyers who are residents of this state.
>
> Again, a controversy has arisen as to whether or not these independent contractors are "representatives" of such retailers within the meaning of Section 6203(b) for use tax collection purposes. Upon researching this issue, the Board determined that such repairmen do not qualify under established United States Supreme Court cases as representatives for nexus purposes because they do not participate in the transfer of the property from the out-of-state retailer to the in-state customer but, rather, become involved with the property after (sometimes long after) the sale transaction is concluded. As more and more out-of-state retailers are out-sourcing their warranty responsibilities to instate independent contractors rather than maintaining in-state repair facilities, and no statute addresses this issue, the Board concluded that it was necessary for it to bring certainty to this issue by regulatory action.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding warranty and repair services was based upon the Board's 1997 interpretation of United States Supreme Court cases.

Interested Parties Process

Initial Interested Parties Meetings
During the Board's Business Taxes Committee meeting on July 26, 2011, the Board directed its staff to review ABx1 28 (Stats. 2011, ch.7), which made almost identical amendments to section 6203 as AB 155 and conduct interested parties meetings to discuss whether the Board should amend Regulation 1684 to implement, interpret, and make specific the amendments made to section 6203 by ABx1 28. However, before staff could begin the interested parties process, the Legislature repealed the amendments made to section 6203 by ABx1 28 and enacted the amendments made to section 6203 by AB 155 (discussed above). Therefore, Board staff reviewed AB 155 and Regulation 1684 and then conducted meetings with interested parties on October 31, 2011, in Sacramento,

California, and November 2, 2011, in Culver City, California, to discuss staff's initial suggestions that Regulation 1684 needs to be amended to:

- Incorporate the new provisions of section 6203 regarding substantial nexus, including provisions addressing commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess* (and affirmed in *Quill*) by creating a rebuttable presumption that, unless otherwise provided in Regulation 1684, a retailer is required to collect California use tax if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier or the United States mail or interstate telecommunication;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new provisions of section 6203 by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Explain that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in the new affiliate nexus provisions of section 6203, refer to commissions or other consideration that is based upon completed sales of tangible personal property, similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;
- Create a means by which a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203 by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident;
- Clarify that an out-of-state retailer that owns a computer server in California and uses the California server to maintain its webpage where it makes retail sales (as opposed to a retailer that merely purchases web services through a third party's servers) has a substantial nexus with California (i.e., a place of business in California where the server is located) and is, thus, obligated to collect California use tax; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

And, to discuss Board staff's initial suggestions that the Board:

- Retain the current provisions of Regulation 1684 regarding Internet service providers, online service providers, internetwork communication service providers, other Internet access service providers, and World Wide Web hosting services based upon the Board's 1997 interpretation of *Quill*; and

- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

After reviewing Board's staff's suggestions, the interested parties recommended:

- Revising staff's suggested amendments adding subdivision (c)(2) to Regulation 1684 to incorporate the commonly controlled group nexus provisions of new section 6203, subdivision (c)(4), so that subdivision (c)(2) of the regulation defines the phrase "in cooperation with," as used in new section 6203, subdivision (c)(4), so that it only refers to activities performed directly for or on behalf of a retailer, and clarifies that new section 6203, subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state services that enable the out-of-state retailer to create or maintain an in-state market;
- Revising staff's suggested amendments incorporating the affiliate nexus provisions of new section 6203, subdivision (c)(5), into Regulation 1684 in order to: (A) define the phrase "person or persons in this state" so that it only refers to an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California; (B) clarify that creating a sales and use tax collection obligation based on the presence of an in-state person who refers customers must be limited to those in-state persons who are performing activities to establish or maintain a California market; (C) clarify the phrase "other consideration"; (D) explain what the phrases "directly or indirectly," "indirectly solicit," "indirect solicitation," and "or otherwise" mean with examples; (E) clarify whether a static link that is labeled "click here" constitutes a solicitation; and (F) explain that the method of compensation should not convert an otherwise permissible advertisement into a market-making activity that leads to nexus;
- Revising staff's suggested amendments creating a means by which a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203, subdivisions (c)(5), by utilizing contractual terms and factual certifications so that: (A) the contractual terms do not prohibit an advertising agreement from providing for the payment of commissions based upon completed "click-through" sales; and (B) retailers are excused from obtaining certificates where it would be impossible to do so, for example, where the in-state person is deceased; and
- Deleting staff's suggested amendments to Regulation 1684's website provisions because the amendments may violate the Internet Tax Freedom Act (ITFA), and deleting staff's suggested amendments adding subdivision (b)(2) to Regulation 1684 because the rebuttable presumption in subdivision (b)(2) may be inconsistent with the United States Supreme Court's view of the Commerce Clause.

In addition, staff received a written comment, which noted that Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner published statements of intent in the September 9, 2011, Assembly Daily Journal to memorialize their understanding that the provisions of section 6203, subdivision (c)(5)(A)-(C), were intended to:

> [D]raw a clear line between activities that are "mere advertising" versus more sufficiently meaningful in-state activity that should properly be characterized as "soliciting business" for purposes of meeting the definition of a "retailer engaged in business in this state." Given the evolving nature of online advertising, and the anonymous manner in which it may be delivered to online customers, it is important to note that, in isolation, online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites, and similar online advertising services should not be considered a "referral" under subparagraph (5)(A), nor "direct or indirect solicitation specifically targeted at potential customers in the state" under subparagraph (5)(C). Those types of advertising services are generated as a result of generic algorithmic functions and are anonymous and passive in nature and thus do not rise to the level of referring or soliciting business. Agreements for such advertising services are not covered, unless the person entering the agreement also engages in other activities on behalf of the retailer in this state – such as sending flyers or making phone calls – that are specifically targeted at customers in this state.

The written comment also recommended revising staff's suggesteded amendments incorporating the affiliate nexus provisions of new section 6203, subdivision (c)(5), into Regulation 1684 so that the amendments further provide that the terms "solicit" and "solicitation" do not include "online advertising, including those ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites and similar online advertising services."

Board staff agreed to revise its suggested amendments adding subdivision (c)(2) to Regulation 1684 to define the phrase "in cooperation with" and clarify that subdivision (c)(2) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property because the United States Supreme Court and the California Court of Appeal have held that these types of in-state services establish a substantial nexus in *Tyler Pipe* and *Borders Online*, respectively. Therefore, staff added a new paragraph (c)(2)(B)(i) to its suggested amendments to Regulation 1684 to provide that "services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property." Staff also added new paragraph (c)(2)(B)(ii) to its suggested amendments to Regulation 1684 to define "in cooperation with" in accordance with the general definition of the term, which is that "cooperation" is "an act or instance of working or acting together for a common purpose or benefit." (Dictionary.com.)

Board staff also generally agreed that the phrase "other consideration" should be further clarified. Therefore, Board staff revised its suggested amendments incorporating the affiliate nexus provisions into Regulation 1684 so that they further explain that the consideration referred to in section 6203, subdivision (c)(5), as added by AB 155, is any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise."

Further, Board staff generally agreed that the method of compensation should not convert an otherwise permissible advertisement into a market-making activity that establishes a substantial nexus. Therefore, Board staff revised its suggested amendments explaining how a retailer may effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus so that the amendments do not prohibit an agreement from providing for the payment of commissions.

Moreover, Board staff generally agreed that retailers should be excused from obtaining certificates to establish that their in-state affiliates did not perform prohibited solicitation activities in California under appropriate circumstances, including where the person required to make the certification is deceased. Therefore, Board staff revised its suggested amendments so that the amendments excuse retailers from having to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

Additionally, after reviewing the statements of intent published by Senator Hancock and Assembly Members Blumenfield, Calderon, and Skinner in the September 9, 2011, Assembly Daily Journal in detail and interpreting the amendments made to section 6203 by AB 155 in light of the statements of intent, staff concluded that:

- Based on the language in subdivision (c)(5)(B) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer purchases advertisements from a person in this state to be delivered on television, radio, in print, on the Internet, or by any other medium when the advertisement revenue paid to the person *is not based* on commissions or other consideration that is based upon completed sales of tangible personal property. However, the affiliate nexus provisions of new subdivision (c)(5)(A) *do apply* to such agreements when the advertisement revenue paid *is based* on commissions or other consideration that is based upon completed sales of tangible personal property.

- Based on the language in subdivision (c)(5)(C) of section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions *do not apply* to agreements under which a retailer engages a person in this state to place an advertisement on an Internet website operated by that person, or operated by another person in this state, if the person entering into the agreement with the retailer *does not* directly or indirectly

solicit potential customers in this state through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state. However, the affiliate nexus provisions of subdivision (c)(5)(A) *do apply* to such agreements when the person directly or indirectly *does* solicit potential customers in California through such means.

- The Senator and Assembly Members intended for the new provisions of section 6203, subdivision (c)(5)(A)-(C) "to draw a clear line between activities that are 'mere advertising' versus more sufficiently meaningful in-state activity that should properly be characterized as 'soliciting business' for purposes of meeting the definition of a 'retailer engaged in business in this state.'"

- The Senator and Assembly Members did not intend for section 6203, subdivision (c)(5)(A)'s new affiliate nexus provisions to apply to an agreement under which a retailer purchases online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as anonymous and passive ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services. In short, the Senator and Assembly members have implicitly presumed that persons who enter into this type of agreement with a retailer generally do not directly or indirectly solicit potential customers for the retailer in California.

In other words, staff concluded that the Legislature intended to create a distinction between "traditional" advertising contracts (i.e., contracts for the sale of advertising space or time with no presumed solicitation) and potentially "nexus-producing" contracts that are not limited to the sale or purchase of traditional advertising (i.e., commission-based contracts with presumed solicitation). Staff also concluded that the Senator and Assembly members believed that anonymous and passive online advertising should be viewed as traditional advertising so that out-of-state retailers will not be required to register with the Board to collect use tax solely because they purchase anonymous and passive online advertising. Therefore, staff generally agreed that staff's suggested amendments to Regulation 1684 should clarify that: (1) the term "advertisement" includes anonymous and passive online advertising, such as anonymous and passive ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailer websites, and similar online advertising; and (2) the terms "solicit," "solicitation," "refer," and "referral" do not include the same types of anonymous and passive online advertising.

However, Board staff did not agree with all of the interested parties comments. Board staff concluded that the proper administration of the amendments made to section 6203, subdivision (c), by AB 155, requires that the Board establish a presumption that a retailer is engaged in business in California if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier, the United States mail, or interstate telecommunication (i.e., a presumption that a retailer is "engaged in business in

California" if the retailer has any in-state physical presence). Retailers can rebut this presumption by establishing that their physical presence in California is so slight that it cannot create a substantial nexus within the meaning of the Commerce Clause. Furthermore, Board staff concluded that the rebuttable presumption set forth in staff's suggested amendments adding subdivision (b)(2) to Regulation 1684 is consistent with the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*) because the presumption only applies when a retailer has a physical presence in California and the presumption that the physical presence creates a substantial nexus and corresponding use tax collection obligation can be rebutted if the retailer can show that its physical presence is so slight that it will not satisfy the physical presence test established in *National Bellas Hess* (and reaffirmed in *Quill*). Therefore, staff did not delete the rebuttable presumption from its suggested amendments adding subdivision (b)(2) to Regulation 1684.

Board staff did not agree that the phrase "person or persons in this state" needs to be defined so that it only refers to "an individual that is a California resident or a business legal entity that is commercially domiciled or headquartered in California." The term "person" is broadly defined by section 6005 and the recommended definition is inconsistent with that section. Furthermore, an individual does not need to be a resident of California and a legal entity does not need to be headquartered or domiciled in California in order to perform services in this state.

Board staff did not agree to define the terms "directly," "indirectly," and "otherwise" because these are all broad terms with generally applicable meanings. However, Board staff indicated that it was open to further discussion regarding adding examples to Regulation 1684 that would help clarify the meaning of these terms.

Furthermore, Board staff found that ITFA, as renewed in 2007, imposes a moratorium on the states' imposition of two categories of taxes during the period beginning November 1, 2003, and ending November 1, 2014:

- Taxes on internet access, which means taxes imposed on a service that enable users to connect to the Internet to access content, information, or other services offered over the Internet, whether imposed on the provider or the consumer; and
- Multiple or discriminatory taxes on electronic commerce. (ITFA §§ 1101(a), 1105(5).)

ITFA provides that the term "tax" includes "the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity." (ITFA § 1105(8).) ITFA provides that "[t]he term 'multiple tax' means any tax that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions." However, the term "multiple tax" does "not include a sales or use tax imposed by a State and 1 or more political subdivisions thereof on the same electronic

commerce or a tax on persons engaged in electronic commerce which also may have been subject to a sales or use tax thereon." (ITFA § 1105(6)(A) & (B).) ITFA further provides that "The term 'discriminatory tax' means –

> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that – (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period; (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means; (iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or
>
> (B) any tax imposed by a State or political subdivision thereof, if – (i) the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or (ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of – (I) the display of a remote seller's information or content on the out-of-State computer server of a provider of Internet access service or online services; or (II) the processing of orders through the out-of-State computer server of a provider of Internet access service or online services. (ITFA § 1105(2).)

ITFA also provides that except as expressly provided, "nothing in this title shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act." (ITFA § 1101(b).)

Therefore, Board staff did not agree that its suggested amendments to Regulation 1684's website provisions violate ITFA. This is because the amendments cannot reasonably be interpreted to impose taxes on Internet access, or multiple or discriminatory taxes within the above ITFA definitions. Board staff also concluded that the suggested amendments merely recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state. Further, Board staff concluded that the suggested amendments do not discriminate against Internet access

providers or electronic commerce retailers because whatever use tax collection obligation may be imposed as a result of the amendments:

- Is generally imposed and legally collectible by California, at the same rate, on transactions involving similar property and goods accomplished through other means involving the presence of a retailer's property in this state; and
- Will not be imposed on a different person or entity than in the case of transactions involving similar property and goods accomplished through other means.

In addition, Board staff concluded that the suggested amendments will not require a retailer to collect California use tax solely because California consumers can access the retailer's "out-of-State computer server" via the Internet or deem a provider of Internet access service or online services to be the agent of a retailer for determining the retailer's use tax collection obligation solely as a result of the display of the retailer's information or content on "the out-of-State computer server of a provider of Internet access service or online services" or the processing of orders through "the out-of-State computer server of a provider of Internet access service or online services."

Subsequent Interested Parties Meetings
Board staff conducted additional meetings with interested parties on December 20, 2011, in Sacramento, California, and December 22, 2011, in Culver City, California, to further discuss the comments and responses summarized above, and staff's revisions to its original suggested amendments to Regulation 1684. After the additional interested parties meetings, the interested parties recommended that Board staff:

1. Delete the rebuttable presumption from the suggested amendments adding subdivision (b)(2) to Regulation 1684 or replace the reference to "physical connection" with a reference to "physical presence" in the suggested amendments in order to make the rebuttable presumption more consistent with the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*).
2. Further clarify when a person or persons are "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155, and clarify that subdivision (c)(5)(A) only applies to a retailer when there is a person who is conducting referral "activities in California" that help the retailer establish or maintain a California market.
3. Include examples in the suggested amendments to Regulation 1684 to clarify whether the in-state activities described therein will or will not constitute the "indirect solicitation" of California customers within the meaning of section 6203, subdivision (c)(5)(C), as added by AB 155.
4. Consider adding "unless the computer server located in California is owned or leased by the out-of-state retailer" to the end of the first sentence in Regulation 1684's current provisions regarding webpages and Internet services providers, instead of staff's suggested amendments revising the same sentence so that it begins with the phrase "The use of an unrelated third party's computer server . . . ."

Board staff agreed that the suggested amendments adding subdivision (b)(2) to Regulation 1684 would be more clear if the term "physical connection" was replaced with the term "physical presence" from the "physical presence" test established in *National Bellas Hess* (and reaffirmed in *Quill*). In addition, Board staff concluded that it would be helpful if subdivision (b)(2) to Regulation 1684 explained how a retailer with a "physical presence" in California can rebut the presumption that it has a "substantial nexus" with and therefore is engaged in business in California (i.e., by establishing that its physical presence in California is so slight that a finding of substantial nexus would not be constitutionally permissible). Board staff also concluded that it would be helpful to add an additional subdivision (b)(3) to Regulation 1684 to further clarify that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California. Therefore, Board staff revised its suggested amendments adding subdivision (b) to Regulation 1684, accordingly.

Board staff further agreed that it would be helpful if the suggested amendments to Regulation 1684 clarified when a person is "in this state" within the meaning of section 6203, subdivision (c)(5)(A), as added by AB 155. In addition, Board staff concluded that it would be helpful if Regulation 1684 further clarified that subdivision (c)(3), as suggested to be added to Regulation 1684, only applies to a retailer when an individual solicits potential customers under the retailer's agreement while the individual is physically present within the boundaries of California, and that such additional clarification would help ensure that subdivision (c)(3) is interpreted and administered consistently with *Tyler Pipe* and *Borders Online*. Therefore, Board staff suggested adding a new subdivision (c)(5) to Regulations 1684 to further clarify when an individual is in this state within the meaning of section 6203, subdivision (c)(5)(A), and adding a new subdivision (c)(6) to Regulation 1684 to clarify when subdivision (c)(3) of Regulation 1684 applies. Board staff also suggested adding new subdivision (c)(8)(B) and (C) to Regulation 1684 to define the term "individual" as referring to a "natural person" and define the term "person" by reference to the definition in section 6005.

Additionally, Board staff agreed that it would be helpful to add examples to Regulation 1684 to illustrate the application of subdivision (c)(3), as suggested to be added to Regulation 1684, and provide examples of "direct and indirect" solicitation within the meaning of subdivision (c)(3). Therefore, Board staff suggested adding subdivision (c)(9) to Regulation 1684 to provide examples that staff believes will be helpful to illustrate when the "direct and indirect" solicitation activities are present that are necessary to create "affiliate nexus" under subdivision (c)(3).

Finally, staff agreed with the alternative amendments to the first sentence in Regulation 1684's current provisions regarding webpages and Internet service providers and staff incorporated the alternative amendments into its suggested amendments to Regulation 1684. Staff concluded that the alternative amendments achieve staff's intended purpose,

which was to amend the provisions regarding webpages and Internet service providers to recognize that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state.

Proposed Amendments

At the conclusion of the interested parties process, Board staff prepared Formal Issue Paper 12-003, which raised the issue of whether the Board should amend Regulation 1684 to implement, interpret, and make specific the amendments made to section 6203 by section 3 of AB 155 (the problem to be addressed for purposes of Government Code section 11346.2, subdivision (b)(1)), summarized the interested parties process discussed above, and recommended that the Board amend Regulation 1684 to:

- Incorporate the new provisions of section 6203, subdivision (c), as amended by AB 155, providing that "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty," and incorporate the non-exhaustive examples of retailers with substantial nexus set forth in section 6203, subdivision (c)(1)-(5), as amended by AB 155, including the examples regarding commonly controlled group nexus and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753 (and affirmed in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298) by creating a presumption that a retailer is engaged in business in this state if the retailer has any physical presence in California, and further explain that a retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer, that a retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails, and that the rebuttable presumption does not apply to a retailer that does not have a physical presence in California;
- Clarify that services are performed in connection with tangible personal property to be sold by a retailer, within the meaning of section 6203, subdivision (c)(4)'s new commonly controlled group nexus provisions, if the services help the retailer establish or maintain a California market for sales of tangible personal property, and clarify that services are performed in cooperation with a retailer, within the meaning of section 6203, subdivision (c)(4), as added by AB 155, if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit;
- Clarify that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5)'s new affiliate nexus provisions, refer to

any "consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise," similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;

- Clarify that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5)'s new affiliate nexus provisions shall be made at the end of each calendar quarter;
- Clarify that, for purposes of section 6203, subdivision (c)(5)'s new affiliate nexus provisions, an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf, and further clarify that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor;
- Create a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident; and expressly excuse retailers from obtaining a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year;
- Define the terms "advertisement," "solicit," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5) by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting, and making the definitions for the terms "advertisement," "solicit," "solicitation," "refer" and "referral" consistent with staff's understanding of section 6203, subdivision (c)(5), and Senator Hancock's and Assembly Members Blumenfield's, Calderon's, and Skinner's intent;
- Define the term "person" by reference to the definition of "person" set forth in section 6005 and define the term "individual" to mean a "natural person" for purposes of applying the new affiliate nexus provisions of section 6203, subdivision (c)(5);

- Provide three examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);
- Recognize and provide notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

Formal Issue Paper 12-003 also contained staff's recommendations that the Board:

- Retain the other current provisions of Regulation 1684 regarding Internet service providers, online service providers, internetwork communication service providers, other Internet access service providers, and World Wide Web hosting services based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 12-003 during its February 28, 2012, Business Taxes Committee meeting, and the Board voted to propose the adoption of staff's recommended amendments because the Board determined that the amendments are reasonably necessary for the specific purposes of:

- Making Regulation 1684 consistent with the amendments made to section 6203 by AB 155;
- Providing notice to retailers that California will be a "substantial nexus state" (impose the obligation to collect California use tax to the fullest extent permitted by the Commerce Clause) and that a retailer with a physical presence in California will be required to register to collect California use tax, unless the retailer can show that its physical presence is so slight that the Commerce Clause will not permit California to impose a use tax collection obligation on the retailer or the retailer is otherwise exempt from registering to collect use tax, when the amendments made to section 6203 by AB 155 are operative;
- Incorporating the new commonly controlled group nexus provisions added to section 6203, subdivision (c)(4), by AB 155, defining the phrase "in cooperation with" as used in subdivision (c)(4), and clarifying that subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property;
- Incorporating the new affiliate nexus provisions added to section 6203, subdivision (c)(5), by AB 155; clarifying the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales

of tangible personal property," as used in section 6203, subdivision (c)(5); clarifying that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5) shall be made at the end of each calendar quarter; clarifying that, for purposes of section 6203, subdivision (c)(5), an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf; clarifying that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California; creating a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications; defining the terms "advertisement," "individual," "person," "solicit," and "solicitation" for purposes of applying section 6203, subdivision (c)(5); and providing examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5);

- Recognizing and providing notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state; and
- Providing that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

The proposed amendments are anticipated to provide the following benefits:

1. Ensure that Regulation 1684 is consistent with the provisions of new section 6203, when new section 6203 becomes operative;
2. Give needed guidance to retailers as to whether their activities create a "substantial nexus" with California and will require them to register with the Board to collect use tax when new section 6203 becomes operative;
3. Ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess*, *Quill*, *Tyler Pipe*, *Scripto*, *National Geographic Society*, *Current*, and *Borders Online*; ans
4. Ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently.

The proposed amendments to Regulation 1684 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1684.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 12-003, all but one of the exhibits to the formal issue paper, and the comments made during the Board's discussion of the formal issue paper during its February 28, 2012, Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1684 described above. During the committee meeting, Betty T. Yee, Board Member for the Board's First Equalization District and Business Taxes Committee Chairwoman, acknowledged Senator Hancock's and Assembly Members Blumenfield's, Calderon's, and Skinner's statements of intent published in the September 9, 2011, Assembly Daily Journal, and included in exhibit 3 to Formal Issue Paper 12-003. However, Ms. Yee noted that the statements were letters expressing the Senator's and Assembly Members' personal intent, not binding statements of the entire Legislature's intent included in operative provisions of AB 155, and that, regardless of the statements, technology is changing and the Board has the discretion to revisit the issue of whether online advertising may constitute soliciting within the meaning of section 6203 if technology changes so that future online advertising is not necessarily the result of algorithmic functions that are anonymous and passive in nature. Furthermore, the Board voted to clarify in the rulemaking record that the statements of intent are not supporting documents (authority or reference) for the proposed amendments.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1684 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1684 that would lessen any adverse impact the proposed action may have on small business or that would be lessen burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

Sections 6203 and 6226 collectively require a "retailer engaged in business in this state" to register with the Board and collect California use tax from its California customers.

Also, section 6204 makes a retailer personally liable for any California use tax it fails to collect from its California customers, as required by section 6203.

Regulation 1684 currently requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board. Regulation 1684 does not currently regulate the health and welfare of California residents, worker safety, or the state's environment.

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and the amendments made by AB 155 will become operative on either September 15, 2012, or January 1, 2013. New subdivision (c) will provide that the term "retailer engaged in business in this state" means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty" and provide that retailers with substantial nexus, include, but are not limited to, retailers with commonly controlled group nexus and affiliate nexus (as discussed in detail above). Therefore, any retailer that has a "substantial nexus" with California, including a retailer with commonly controlled group nexus or affiliate nexus, will be required to register with the Board to collect California use tax when the amendments made to section 6203 by AB 155 become operative, regardless of whether the Board adopts the proposed amendments.

The proposed amendments to Regulation 1684 will help retailers better understand whether they are obligated to register to collect California use tax when the amendments made to section 6203 by AB 155 become operative by:

- Making Regulation 1684 consistent with the amendments made to section 6203 by AB 155;
- Providing notice to retailers that California will be a "substantial nexus state" and that a retailer with a physical presence in California will be required to register to collect California use tax, unless the retailer can show that its physical presence is so slight that the Commerce Clause will not permit California to impose a use tax collection obligation on the retailer or the retailer is otherwise exempt from registering to collect use tax, when the amendments made to section 6203 by AB 155 are operative;
- Incorporating the new commonly controlled group nexus provisions added to section 6203, subdivision (c)(4), by AB 155, defining the phrase "in cooperation with" as used in subdivision (c)(4), and clarifying that subdivision (c)(4) only applies when a member of an out-of-state retailer's commonly controlled group is performing in-state "services" that help the out-of-state retailer to establish or maintain a California market for sales of tangible personal property;
- Incorporating the new affiliate nexus provisions added to section 6203, subdivision (c)(5), by AB 155; clarifying the phrases "commission or other

consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in section 6203, subdivision (c)(5); clarifying that the determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period to be engaged in business in California under section 6203, subdivision (c)(5) shall be made at the end of each calendar quarter; clarifying that, for purposes of section 6203, subdivision (c)(5), an individual is in California when the individual is physically present within the boundaries of California and a person other than an individual is in California when there is at least one individual physically present in California on the person's behalf; clarifying that the affiliate nexus provisions do not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California; creating a means by which a retailer may effectively establish that its agreement is not the type of agreement that can give rise to affiliate nexus under section 6203, subdivision (c)(5) by utilizing contractual terms and factual certifications; defining the terms "advertisement," "individual," "person," "solicit," and "solicitation" for purposes of applying section 6203, subdivision (c)(5); and providing examples illustrating the application of the new affiliate nexus provisions of section 6203, subdivision (c)(5); and

- Providing notice that a retailer may establish a substantial nexus with California by having its property, including a computer server, in this state. (As discussed in detail above.)

Furthermore, the proposed amendments to Regulation 1684 are consistent with section 6203, as amended by AB 155, the proposed amendments will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect, and the proposed amendments will not impose any new taxes or expand any retailer's use tax collection obligation beyond that imposed by new section 6203 when the amendments made to section 6203 by AB 155 become operative (as discussed in detail above). Therefore, the Board has determined that the adoption of the proposed amendments to Regulation 1684 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. The Board has also determined that the adoption of the proposed amendments to Regulation 1684 will not affect the health and welfare of California residents, worker safety, or the state's environment.

In addition, the forgoing information provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1684 will not have a significant adverse economic impact on business.

The proposed amendments may affect small business.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1684

Section 1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in s~~S~~ection 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a presumption that a retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer has any physical presence in California. A retailer may rebut the presumption if the retailer can substantiate that its physical presence is so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer.

(3) A retailer does not have a physical presence in California solely because the retailer engages in interstate communications with customers in California via common carrier, the United States mail, or interstate telecommunication, including, but not limited to, interstate telephone calls and emails. The rebuttable presumption in subdivision (b)(2) does not apply to a retailer that does not have a physical presence in California.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer owns or leases real or tangible personal property, including, but not limited to, a computer server, in California; or

(B) ~~Any~~The retailer ~~deriving~~derives rentals from a lease of tangible personal property situated in California (under such circumstances~~this state is a "retailer engaged in business in this state" and~~ the retailer is required to collect the tax at the time rentals are paid by the~~his~~ lessee); or~~.~~

(C) The retailer maintains, occupies, or uses, 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 in California; or

(D) The retailer has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California 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, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer. For purposes of this paragraph:

(i) Services are performed in connection with tangible personal property to be sold by a retailer if the services help the retailer establish or maintain a California market for sales of tangible personal property; and

(ii) Services are performed in cooperation with a retailer if the retailer and the member of the retailer's commonly controlled group performing the services are working or acting together for a common purpose or benefit.

(3) A retailer is engaged in business in this state as defined in section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a consideration that is based upon completed sales of tangible personal property, whether referred to as a commission, fee for advertising services, or otherwise, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website, or otherwise, provided that:

(A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a

person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12-month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes.

(4) Paragraph (3) does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless:

(A) The advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and

(B) The person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(5) For purposes of paragraph (3):

(A) A person that is an individual is in this state when the person is physically present within the boundaries of California; and

(B) A person other than an individual is in this state when there is at least one individual physically present in California on the person's behalf.

(6) Paragraph (3) does not apply to a retailer's agreement with any person, unless an individual solicits potential customers under the agreement while the individual is physically present within the boundaries of California, including, but not limited to, an individual who entered into the agreement directly with the retailer, an individual, such as an employee, who is performing activities in California directly for a person that entered into the agreement with the retailer, and any individual who is performing activities in California indirectly for any person who entered into the agreement with the retailer, such as an independent contractor or subcontractor.

(7) Paragraph (3) does not apply if a retailer can demonstrate that all of the persons with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement:

(i) Prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; and

(ii) If the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its website information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its website includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

A retailer is excused from the requirement to obtain a certification if the person from whom the certification is required is dead, lacks the capacity to make such certification, or cannot reasonably be located by the retailer and there is no evidence to indicate that such person did in fact engage in any prohibited solicitation activities in California at any time during the previous year.

(8) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public. Online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services, are advertisements and not solicitations.

(B) "Individual" means a natural person.

(C) "Person" means and includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.

(D) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(E) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(F) "Solicit," "solicitation," "refer," and "referral" do not mean or include online advertising generated as a result of generic algorithmic functions that is anonymous and passive in nature, such as ads tied to Internet search engines, banner ads, click-through ads, Cost Per Action ads, links to retailers' websites, and similar online advertising services.

(9) Examples:

(A) Corporation X is physically located in California and maintains a website at www.corporationx.com. Corporation X enters into agreements with one or more hiking gear and accessories retailers under which Corporation X maintains click-through advertisements or links to each retailer's website on Corporation X's website at www.corporationx.com and Corporation X's webpage at www.socialnetwork.com/corporationx in return for commissions based upon the retailers' completed sales made to customers who click-through the ads or links on Corporation X's website and webpage. Corporation X also posts reviews at www.corporationx.com of the products sold through the click-through ads and

links on its website and webpage. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(B) Same as (A) above, except that Corporation X also enters into an agreement under which Advertising Corporation places advertisements for www.corporationx.com on other businesses' websites and webpages, and mails or emails advertisements for www.corporationx.com to anyone who signs up to receive such advertisements. However, Corporation X does not engage in any solicitation activities in California that refer potential customers to the retailer or retailers who have click-through ads or links on its website or webpage and Advertising Corporation's mailers and emails are advertisements, not solicitations. Therefore, paragraph (3) does not apply to the agreements between Corporation X and the retailer or retailers who have ads or links on Corporation X's website or webpage.

(C) Same as (B) above, except that an individual representative of Corporation X or any other individual acting on behalf of Corporation X, including, but not limited to, an employee or independent contractor of Corporation X or Advertising Corporation, engages in solicitation activities, such as soliciting customers in person, soliciting customers on the telephone, handing out flyers that are solicitations, or sending emails that are solicitations, while physically present in California that refer potential California customers to a retailer who has a click-through ad or link on Corporation X's website or webpage under Corporation X's agreement with that retailer. Therefore, paragraph (3) does apply to Corporation X's agreement with that retailer and that retailer will be required to register with the Board to collect use tax if:

(i) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described in paragraph (3), in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and

(ii) The retailer's total cumulative sales of tangible personal property to purchasers in California is in excess of one million dollars ($1,000,000) in the preceding 12 months.

(d) Exceptions.

(1) Webpages and Internet Service Providers. The use of a computer server on the Internet to create or maintain a World Wide Web page or site by a~~n out-of-state~~ retailer will not be considered a factor in determining whether the retailer has a

substantial nexus with California, unless the computer server is located in California and the retailer owns or leases the computer server. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(3~~b~~) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(A~~1~~) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(B~~2~~) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~e~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~f~~d) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~g~~e) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~h~~f) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No. 155), section 3 re-enacted section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1684

Title: 1684, *Collection of Use Tax by Retailers*

Preparation: Brad Heller
Legal Contact: Brad Heller

Board proposes to amend Regulation 1684, *Collection of Use Tax by Retailers*, to interpret the amendments made to RTC section 6203 by AB 155 (Stats. 2011, ch. 313) regarding the definition of "retailer engaged in business in this state."

History of Proposed Regulation:

May 30-31, 2012	Public Hearing
April 6, 2012	OAL publication date; 45-day public comment period begins; Interested Parties mailing
March 27, 2012	Notice to OAL
February 28, 2012	Business Tax Committee, Board Authorized Publication (Vote 4-0)

Sponsor:	NA
Support:	NA
Oppose:	NA