

**STATE BOARD OF EQUALIZATION**

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May 1, 2009

Ms. --- -. [H]
Associate Director of Accounting
[I]
XXXX --- ---, Suite XXX
---, --- XXXXX-XXXX

**Re: *Liability to collect use tax as a retailer engaged in business in California
Assignment No. XX-XXX***

I am in receipt of your correspondence addressed to the Legal Department of the Board of Equalization, which has been assigned to me for reply. You state in your inquiry letter that you are writing on behalf of the [CRE], which operates the [I] (Taxpayer), a [state]-based publisher of books focusing on environmental issues. In your inquiry letter, you state, in relevant part, the following:

I am appealing to you to make a legal opinion as to whether we had nexus in California for the period of April 16, 2005 through December 31, 2005.

Until November 30, 2004 we conducted business in [city], CA. We maintained a warehouse and distribution center for the customer service and fulfillment orders for our products (books). We also had three employees telecommuting from home offices in California who were not associated with the warehouse or distribution center and thus not involved in the sales or distribution of the products. As of December 1, 2004 we began fulfillment with the --- Distribution Center in ---, IL. We continued to accept returns on previous sales until December 31, 2004 at the California location. From January 1, 2005 until April 15, 2005 we maintained the distribution center with limited staff in order to complete collections on accounts outstanding as of December 31, 2004. Upon closing the doors on April 15, 2005 we terminated all employees and discontinued leases on all properties. The three non-sales employees continued to work from their home offices. On January 1, 2006 we signed a contract with an independent sales representative in [city 2], CA.

Currently, we are trying to claim exemption for the period of time where we had only the three telecommuting employees. During that time period, no one associated with our company was soliciting or fulfilling any sales of our products.

Before discussing the issues you have raised in more detail below, I note that the facts you provided are not sufficiently complete. Therefore, I have made assumptions throughout this opinion letter to answer your questions. If the actual facts differ from the facts summarized in this letter, or if any of the assumptions I have made are incorrect, the opinions expressed in this letter may not be reliable. Provided that the facts in this letter (both summarized and assumed) are accurate and verifiable by audit, the taxpayer may rely on this response for purposes of Revenue and Taxation Code section 6596. (See Cal. Code Regs., tit. 18, § 1705, subd. (b) [describing the circumstances under which relief from liability is available for reasonable reliance on written advice given by the Board].)

Discussion

As a starting point, California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, § 6051.) This tax is imposed on the retailer who may collect reimbursement from the customer if the contract of sale so provides. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.) California Code of Regulations, title 18, section 1620, subdivision (a)(2)(8) provides that:

Sales tax does not apply when the order is sent by the purchaser directly to the retailer at a point outside this state, or to an agent of the retailer in this state) and the property is shipped to the purchaser, pursuant to the contract of sale, from a point outside this state directly to the purchaser in this state, or to the retailer's agent in this state for delivery to the purchaser in this state, *provided there is no participation whatsoever in the transaction by any local branch, office, outlet or other place of business of the retailer or by any agent of the retailer having any connection with such branch, office, outlet, or place of business.* (Emphasis added.)

Based on the facts you have presented, I assume that the [city], California warehouse and distribution center were no longer used as places of business by Taxpayer after April 15, 2005. Moreover, I assume, for purposes of responding to your inquiry, that from April 16, 2005, until December 31, 2005, Taxpayer sold to California customers from a point outside California and that either (a) title to the property sold passed outside California or (b) title to such property passed inside this state without any participation whatsoever in the transaction by any local branch, office, outlet or other place of business of Taxpayer or by any agents of Taxpayer having any connection to such branch, office, outlet, or place of business. (See Rev. & Tax. Code, § 6051; see also Cal Code Regs., tit. 18, § 1620, subd. (a)(2).) Under such circumstances, Taxpayer would not be subject to sales tax with respect to its sales to California customers. (See Rev. & Tax. Code, § 6051.)

When, as assumed here, sales tax does not apply, use tax is imposed and is measured by the sales price of property purchased from a retailer for storage, use or other consumption in California. (Rev. & Tax. Code, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code, §6202.) A retailer engaged in business in this state (e.g., as Taxpayer apparently concedes it was prior to April 15, 2005) is required to collect this tax from its customer and remit it to the Board. (Rev. & Tax. Code, §§ 6203 and 6204.)

With certain exceptions that do not appear to be relevant to the facts you have presented,¹ Revenue and Taxation Code section (hereafter Section) 6203 imposes a use tax collection obligation on “ ... every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state “ The use tax amounts that retailers engaged in business in this state are required to collect and remit, whether or not these retailers actually collect these amounts, constitute debts owed by these retailers to California. (Rev. & Tax. Code, § 6204.) Subdivision (c)(1)-(2) of Section 6203 sets forth the requirements applicable for determining whether a typical out-of-state retailer is a retailer engaged in business in this state?²

Under Section 6203, subdivision (c)(1), the meaning of “retailer engaged in business in this state” includes any retailer that has ((an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business” in this state. This is true even if the retailer’s place of business in California is unrelated to its sales of tangible personal property. (*National Geographic Society v. State Bd. of Equalization* (1977) 430 U.S. 551. 562.) Therefore, any retailer with a place of business in California has a use tax collection obligation under Section 6203.

Under Section 6203, subdivision (c)(2), the meaning of “retailer engaged in business in this state” includes:

[a]ny 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.

Thus, for example, when an out-of-state retailer uses an independent contractor or agent to install and/or assemble tangible personal property inside this state, that retailer is engaged in business in this state with a concomitant use tax collection obligation. (See *In the Matter of Robert L. Reynolds and Donald R. Reynolds*, State Board of Equalization Memorandum Opinion, May 31, 2007, at p. 4.)

Based on the facts you have provided, between April 16, 2005, and December 31, 2005, Taxpayer’s sole presence within California consisted of three non-sales employees who telecommuted from their home offices during the entirety of this time period. We assume, based on your representations, that Taxpayer had no other office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business” in conformity with the requirements of Section 6203, subdivision (c)(1). Assuming the three telecommuting, non-sales employees constituted Taxpayer’s sole presence in California during the period in question, and assuming that these three employees did not engage in activities for Taxpayer such as selling, delivering, installing) assembling, or taking orders, it is our opinion that Taxpayer would not be engaged in activities that would make it a “retailer engaged in business” in California during the

¹ For example, for purposes of this letter, I do not take into account whether [I] participates in convention and trade show activities in California. (See Rev. & Tax. Code, § 6203, subd. (e).)

² For purposes of this letter, I assume that [I] does not derive rentals from tangible personal property situated in this state. (See Rev. & Tax. Code, § 6203, subd. (c)(3).)

period in question on the mere basis of the presence of these three employees in California. (See, e.g., Sales and Use Tax Annotation (Annot.) 220.0256 (6/12/99).)³

However, there are also several alternative bases for establishing that a retailer is engaged in business in California that are relevant to the facts in issue. First, it must also be determined whether Taxpayer possessed a current Certificate of Registration - Use Tax or a seller's permit during the time period in question. California Code of Regulations, title 18, section 1684, subdivision (c) provides that:

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 the regulation, the term "Certificate of Registration - Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.⁴

In other words, any retailer who obtains a Certificate of Registration - Use Tax is automatically deemed to be a retailer engaged in business in California and is obligated to collect and report the use tax on its California sales. Such a retailer is obligated to collect the use tax on its California sales until it: (1) cancels its certificate; and (2) is no longer otherwise engaged in activities constituting nexus. (See *In the Matter of B & D Litho. Inc.*, State Board of Equalization Memorandum Opinion, May 31, 2001, at p. 2.)

Moreover, the Board has noted that a retailer's holding of a seller's permit is the retailer's dispositive representation that it is engaged in business in this state. (See *In the Matter of Robert L. Reynolds and Donald R. Reynolds*, State Board of Equalization Memorandum Opinion, May 31, 2007, at p. 5.) Accordingly, it is the opinion of the Board that the holder of a current seller's permit must also collect use tax:

... as long as ... a retailer holds a seller's permit, it is required to comply with the requirement imposed on all holders of seller's permits, including the collecting and remitting of any applicable California use tax. (Ibid.)

In the present case, we understand that Taxpayer held a seller's permit until June 28, 2005. Because Taxpayer held a seller's permit until June 28, 2005, Taxpayer was required to collect and remit any applicable use tax at least until that date. We note that Taxpayer did not obtain a Certificate of Registration - Use Tax until 2006, so Taxpayer was not required to collect and remit use tax based on holding the Certificate of Registration - Use Tax until after the period in question.

³ Annotations do not have the force or effect of law but are intended to provide guidance regarding the interpretation of the Sales and Use Tax Law with respect to specific factual situations. (Ca!. Code Regs., tit. 18, § 5700, subds. (a)(1), (c)(2).)

⁴ See *In the Matter of B & D Litho. Inc.*, State Board of Equalization Memorandum Opinion, May 31, 2001

Second, the Sales and Use Tax Department of the Board (the Department) assumes that even after a retailer ceases activities that had caused it to be “a retailer engaged in business” in California under section 6203, the lingering effects of the retailer’s physical presence in this state continue to generate sales for the retailer for a reasonable period thereafter. So long as the retailer continues to generate sales from the lingering effects of its physical presence in California, the retailer is considered to be engaged in business in this state. This concept is generally referred to as “trailing nexus.” The concept of trailing nexus was implicitly endorsed by the Board when it found that an online bookseller had nexus with California as long as coupons distributed by its in-state representative could be redeemed at its website. (See *In the Matter of Barnes & Noble.com*, State Board of Equalization Memorandum Opinion, September 12, 2002, at p. 5.) The Department’s general approach is to assume that the trailing nexus period generally consists of the quarter in which the retailer ceases the activities that had caused it to be “a retailer engaged in business” in California, as well as the entire quarter that follows. This approach may vary based on the facts and circumstances specific to each retailer. In other words, depending on the facts and circumstances, the period of trailing nexus may be shorter or longer than the general “quarter-plus-a-quarter” approach.

In this case, the Department’s general approach is to assume that Taxpayer continued to have nexus with California for the second quarter (April 1 to June 30) and the third quarter (July 1 to September 30) of 2005. The Department’s assumption would be validated if, during the period from January 1, 2005, through April 15, 2005, the employees working out of Taxpayer’s California distribution center had any contact with California customers who continued to purchase goods from Taxpayer after April 15, 2005. On the other hand, the Department would generally assume that Taxpayer did not have nexus between October 1, 2005, and December 31, 2005. Similarly, if, for example, Taxpayer could show that the distribution center employees in California made no contact with Taxpayer’s California customers after March 31, 2005, then the Department would further generally assume that Taxpayer’s period of trailing nexus ended on June 30, 2005 (i.e., at the end of the second quarter of 2005). As stated above, the Department’s general “quarter-plus-a-quarter” approach may vary depending on the facts and circumstances. We understand that you are currently in communication with the Department’s Out-of-State District Office with regard to Taxpayer’s use tax collection obligations for 2005. By copy of this letter, we ask that the Department work with you to apply the guidance provided in this opinion. In summary, based on the facts and assumptions stated above, Taxpayer was required to collect and remit use tax at least until June 28, 2005, when its seller’s permit was closed. Additionally, the Department’s general approach is to assume that Taxpayer continued to have nexus in California until September 30, 2005, based on the lingering effects of Taxpayer’s prior physical presence in this state, which apparently ended on April 15, 2005.

After discussing this opinion with the Department, you and the Department should feel free to contact me if you have any further questions or concerns.

Sincerely,

Andrew Jacobson
Tax Counsel

AJ/cme

cc: Out-of-State District Administrator (OH)