State of California

Board of Equalization
Legal Division (MIC:82)

M e m o r a n d u m

325.0430

To: Mr. Glenn A. Bystrom
Principal Tax Auditor

Date: January 8, 1992

From: David H. Levine
Senior Tax Counsel

Subject: R--- B--- and C--- W---, Inc.
SR -- XX-XXXXXX-010

This is in response to your memorandum dated December 13, 1991. The audit staff assessed tax on this petitioner's use of tangible personal property in California. Taxpayer petitioned the assessment and the matter is currently pending before the Appeals Unit. Petitioner has filed a brief and you are preparing to respond to it. You ask for our analysis of the brief and our opinion as to whether petitioner is making taxable use of the property in question.

Throughout petitioner's brief, it has mixed apples (the definition of use pursuant to state law) and oranges (restrictions on imposition of tax as required by the Commerce Clause.) Petitioner's brief is so far off base it is hard to know where to start. I will therefore start at the beginning and respond to each of petitioner's incorrect assertions. First, however, I will provide a basic analysis of the case.

Petitioner purchased property outside California. That property was delivered to its warehouse in ---, California either directly from the vendors or after an intermediate stop at one of its subdistribution centers. Some of this property was donated by petitioner to tax-exempt charitable organizations or to other charitable recipients throughout the United States, both inside and outside of California. Some of the recipients were Indian tribes. Substantially of this property was shipped by common carrier from --- to the out-of-state recipients.

Revenue and Taxation Code section 6009.1 excludes from the definition of use the keeping, retaining, or exercising any right or power over tangible perosnal property for the purpose of subsequently transporting the property outside the state for use thereafter solely outside the state. This provision applies to circumstances where a person purchases property outside California, stores it in California, and then transports it outside California for <u>that person's use</u>. A person who transfers property without receiving any consideration (whether the

transfer is characterized as a contribution, donation, or gift) is the consumer of that property for purposes of application of sales and use tax. (See, e.g., BTLG Annotations 165.0040 (4/1/53), 165.0060 (2/7/66, 7/5/89).) We have always regarded that consumption, that is, the use, to have occurred when title passes from the donor to the donee.

When the donation is shipped by common carrier, title passes at the time the donor transfers the property to the carrier. Thus, when a donor places a gift in the mail outside California for shipment to a donee in California, we regard that donor as having consumed the property outside of California. This means that no use tax is applicable since that consumption, which would be subject to tax if occurring inside California, occurred outside California. That the donee will receive and use the property in California does not affect the conclusion since the donee did not purchase the property for use in California. (BTLG Anno. 280.0360 (/18/50).) The reverse is also true. If a donor transfers property to a carrier in California for shipment to a donee outside California, that donor has consumed the property in California at the time the donor has made all the use of that property that he ever will, that is, at he time he gives it away in California. Thus, in Annotation 280.0640 (3/15/60), we concluded that a donor was liable for use tax when he made a gift of merchandise in California if he had purchased the merchandise extax under a resale certificate or outside California. We further noted that there is no exception on account of a subsequent shipment of the property outside California.

In summary, petition made full consumption of the property in question when petitioner transferred possession of the property to the common carrier for shipment to the donee. Since that consumption occurred in California, petitioner owed use tax on all such property purchased without having paid tax.

Analysis of Petitioner's Brief

Petitioner asserts that California courts have held interstate commerce principles applicable to the California use tax. We agree. However, petitioner cites two cases which are simply not applicable. In Flying Tiger v. State Board of Equalization (1953) 157 Cal.App.2d 85, the court held against the plaintiff on each argument regarding exemption from use tax based on interstate commerce. For example, with respect to certain of the aircraft in question, the court held that "there was a taxable moment intermediate the time the aircraft arrived at their home base in California and the time of their first commercial use." (Id. at 97.) In the only portion of the opinion holding in favor of plaintiff, the court held that certain parts were exempt from use tax under Revenue and Taxation Code section 6366. That provision exempts the use of aircraft under certain circumstances. The court concluded that parts installed onto an aircraft prior to its entry into California are regarded as part of the aircraft when the aircraft does enter California. (Id. at 100.) Thus, the parts in question were exempt aircraft. This was a decision in favor of plaintiff strictly on state grounds with no interstate commerce questions involved.

The other case cited for this proposition by petitioner is Stockton Kenworth, Inc. v. State Board of Equalization (1984) 157 Cal.App.3d 334. The provision in question in that case was Revenue and Taxation Code section 6009.1, upon which petitioner also seeks to rely. The board

had interpreted "transporting" for purposes of section 6009.1 as passively transporting property outside California. The court held that the Board could not limit that term to passive transport, but that "transporting" for purposes of section 6009.1 also includes self locomotion. Again, as was the case with Flying Tiger Line, the decision in Stockton Kenworth was based solely on an interpretation of state law and was not applying any interstate commerce exemption.

Petitioner's assertion that section 6009.1 recognizes "these constitutional limitations on use tax" is totally and completely without basis. Section 6009.1 was adopted for reasons other than constitutional prohibitions. If the Legislature repealed that section, there would be no constitutional prohibitions against imposing use tax on use which is currently excluded from taxation by section 6009.1.

Petitioner confuses an exempt sale in interstate commerce by delivery to a carrier for shipment to the purchaser outside California with a taxable consumption in California by way of a gift delivered to a carrier for shipment to the donee outside California. Revenue and Taxation Code section 6396 provides the exemption for sales in interstate commerce where the contract requires the property to be shipped and the property is shipped to a point outside this state by means of delivery to a carrier. This is further explained in Regulation 1620, provisions of which petitioner cites. In the case of a sale in interstate commerce, there is never a question of taxable use by the seller. If tax applies, it is sales tax upon the sale. A sale qualifying as exempt under section 6396 is part of a continuous interstate transaction.

An exemption specifically for sales simply does not apply to consumption in this state. As discussed above, petitioner's transfer of title in California to a donee is a consumption by petitioner. That consumption is fully complete when title is passed to the donee and petitioner no longer has possession of the property in question. There is no exempiton whatsoever for that consumption. Clearly, the provisions of seciton 6396 and subdivision (a)(3) of Regulation 1620, which apply to sales preceding movement of goods from California to points outside the state, simply do not apply to consumption (gifts) in California. On the other hand, if petitioner transported the property outside California in its own facilities, and passed title to the donee outside California, the petitioner would not have been regarded as making a taxable use of the property in California. Rather, such a transaction would have been one that did qualify under section 6009.1. That is, petitioner's storage and transporting the property outside California would have been excluded from the definition of use since petitioner would thereafter use the property solely outside California by way of transfer of title to the donee outside California.

Because of petitioner's inherent lack of understanding of the difference between a sale in interstate commerce and a use fully completed in this state, it makes the incorrect argument that if the department's position were sustained, any shipment of property out-of-state would trigger use tax and render section 6009.1 meaningless. A shipment of property out of state pursuant to a sale that meets the requirements of section 6396 would be exempt from sales tax. Property otherwise subject to use tax in California whose only use in California is storage followed by shipment out of state followed by consumption out of state would not be subject to use tax

pursuant to section 6009.1. However, petitioners use was fully completed upon transfer of title to the donee in California.

Petitioner argues that the department has refused to acknowledge its own regulations for sales tax purposes that delivery to a common carrier for shipment outside California is not a taxable event. Petitioner argues that the same rules are applicable for use tax since both sales and use taxes are subject to the Commerce Clause restrictions. It is well established that the requirements for imposition of sales tax on the sale of property are much higher than those necessary to sustain a state's imposition of use tax on the consumption of the property in that state. Nevertheless, this does not matter here. The exemption in question, section 6396, specifically states that "there are exempted from the computation of the amount of the sales tax . . ." (emphasis added). Subdivision (a)(3) of Regulation 1620 is based upon section 6396. Thus, the rules applicable to sales in interstate commerce do not apply to determination of whether use tax applies. Rather, if the use is not excluded from the definition of use by section 6009.1, that use is subject to use tax in California.

Petitioner's argument that transfers by petitioner in interstate commerce represent the identical type of unwarranted abridgment of section 6009.1 that was prohibited by the court in Stockton Kenworth again shows petitioner's lack of knowledge of the Sales and Use Tax Law. Stockton Kenworth involved the lease of mobile transportation equipment. As we all know, but petitioner apparently does not, the lease of MTE is not a sale under any circumstances under the Sales and Use Tax Law. (Rev. & Tax. Code §§ 6006(g)(4), 6010(e)(4).) Rather, the lessor of MTE is the consumer of that MTE and the lessee's use is regarded as the use of the lessor. In Stockton Kenworth, the lessor transported the MTE outside California for use by the lessor (via leasing) solely outside California.

Petitioner argues that it is not liable for tax pursuant to the provisions of subdivision (a) of Revenue and Taxation Code section 6244 by virtue of section 6009.1. Assuming that petitioner property issued resale certificates for the property in question, if its use of the property in California were, in fact, excluded from the definition of use by section 6009.1, we would agree that no tax applies by virtue of subdivision (a) of section 6244. However, as discussed above, petitioner made use of the property in California by giving it away here, and that use is not excluded by the provisions of section 6009.1. Therefore, taxpayer made a taxable use of the property in California and must pay use tax with respect to that property pursuant to the provisions of subdivision (a) of section 6244. Petitioner's citation of Annotation 570.1165 (8/24/70) does not assist it. That annotation concerned a transaction whereby property was transported for use solely outside of California. That is, the person who stored it in California transported the property outside California for the purpose of using that property outside California. Here, petitioner stored the property in California and made complete use of it in California by giving it away here. Although the property was shipped outside California, the property was not used outside California by petitioner since it had completed its use of the property while the property was in California. The annotation does not apply.

Petitioner makes a ludicrous argument regarding Revenue and Taxation Code section 6403. Petitioner asserts that section 6403, which was enacted in 1988, actually applies to prior years. Furthermore, petitioner argues that an exemption for donations to charities located in California would be unconstitutional in violation of the Equal Protection Clauses of the United States and California Constitutions if not applied also to such charities located outside California. We believe that section 6403 is constitutional and would be upheld if attacked in court. Notwithstanding this opinion, we do not reach this question because the department, the appeals unit, and the Board have no poser to declare section 6403 unenforceable or to refuse to enforce it on the basis of its being unconstitutional unless and until an appellate court has made such a determination. (Cal. Const. Art. 3, § 3.5.) Section 6403 is very clear that it does not apply to donations to charities located outside California. That is what is says and that is how we must interpret it.

If you have further questions, feel free to write again.

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