

**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.

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**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:

<b>MEMBER</b>	Horton	Steel	Yee	Mandel
<b>VOTE</b>	<b>Y</b>	<b>N</b>	<b>Y</b>	<b>Y</b>

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:

<b>MEMBER</b>	Horton	Steel	Yee	Mandel
<b>VOTE</b>	<b>Y</b>	<b>N</b>	<b>Y</b>	<b>Abstained</b>

/s/ Betty T. Yee

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Honorable Betty T. Yee, Committee Chair

/s/ Kristine Cazadd

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Kristine Cazadd, Executive Director

BOARD APPROVED

at the February 29, 2012 Board Meeting

/s/ Diane Olson

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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 Section 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.

(b3) 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) 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;

(2B) 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.

(ee) 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.

(df) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (bd)(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.

(eg) 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.

(fh) 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).