

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for Reallocation)
 4 of Local Tax Under the Uniform Local Sales)
 and Use Tax Law of:)
 5) Case ID 433198
 6 CITY OF TORRANCE)
 7 Petitioner)

8 Retailers: Sellers of technology products

9 Dates of Knowledge: January 23, 2002

10 Allocation periods:¹ April 1, 2001 – Current (Retailer 1)
 11 October 1, 2004 – Current (Retailer 2)

12 Amounts at issue (Retailer 1):²
 In dispute \$4,428,956
 13 Proposed to be reallocated \$492,106

14 Notifications (Retailer 1): The Cities of Anaheim, Costa Mesa, Irvine, Long Beach,
 Los Angeles, Pasadena, San Diego, San Jose, Santa Ana,
 15 Santa Monica, the City and County of San Francisco, and
 the County of Los Angeles

16 Amounts at issue (Retailer 2):³
 17 In dispute: \$885,800
 Proposed to be reallocated: \$98,423

18 Notifications (Retailer 2): The City of Los Angeles and the City and County of San
 19 Francisco

21 ¹ Where a retailer remains engaged in the same activities covered by the petition, as here, we regard the allocation period as
 22 extending through the end of the last quarter for which a return is due prior to any Board hearing.

23 ² The combined amount is based on the retailer's actual local tax reported to the various countywide pools for the period
 July 1, 2002, through September 30, 2010 (\$4,921,062). Also at issue is the amount of local tax the retailer reported to
 24 petitioner for the period April 1, 2001, through June 30, 2002 (\$975,384). If the petitioner were to prevail on all issues,
 approximately \$4,921,062 would be reallocated to petitioner from the countywide pools, less the amount petitioner
 already received as its share of the countywide pools. If, instead, our recommendation is upheld to grant a portion of the
 25 petition in accordance with the Decision and Recommendation and deny the remainder, approximately \$492,106 (10%)
 would be reallocated to petitioner from the countywide pools for the period July 1, 2002, through September 30, 2010,
 and \$877,846 (90% \$975,384 - \$97,538) would be "deallocated" from petitioner to the countywide pools for the period
 26 April 1, 2001, through June 30, 2002, resulting in a net deallocation of about \$385,740.

27 ³ The combined amount is based on the retailer's actual local tax reported to the various countywide pools for the period
 October 1, 2004, through September 30, 2010 (\$984,223). If the petitioner were to prevail on all issues, approximately
 28 \$984,223 would be reallocated to petitioner from the countywide pools, less the amount petitioner already received as its
 share of the countywide pools. If, instead, our recommendation is upheld to grant a portion of the petition in accordance
 with the Decision and Recommendation and deny the remainder, approximately \$98,423 would be reallocated to
 petitioner from the countywide pools.

1 An oral hearing on this petition was scheduled for December 15, 2010. However, in an email
2 to the Board Proceedings Division, petitioner requested a decision on the record without oral hearing.

3 UNRESOLVED ISSUE

4 Whether the disputed sales were subject to the local sales tax because the orders were taken at
5 the retailers' Torrance office, even though the goods were shipped to California customers from
6 outside this state. We conclude that these sales occurred outside California and were thus subject to
7 local use tax, and that a portion of the amount allocated to petitioner by Retailer 1 should be
8 deallocated to the various countywide pools as local use tax.

9 The retailers whose local taxes are the subject of this petition sold technology products through
10 an office located in California. At the corporate headquarters and sales office the retailers shared in
11 Torrance, the operations included a telephone call center for catalog sales, a computer server used to
12 maintain websites for Internet sales, and a retail store for over-the-counter sales. The retail store was
13 initially operated by Retailer 1, and its operations were transferred to Retailer 2 on October 1, 2004. In
14 addition, on October 1, 2004, the Internet sales to small volume customer accounts were transferred to
15 Retailer 2. The local tax at issue was reported directly to petitioner by Retailer 1 during the period
16 April 1, 2001, through June 30, 2002, and to the countywide pools where the goods were shipped
17 beginning July 1, 2002. Retailer 2 reported local tax to the countywide pools where the goods were
18 shipped from the beginning of its operations, on October 1, 2004. During an investigation which
19 began in January 2002, the Sales and Use Tax Department (Department) discovered that goods for
20 catalog orders and Internet orders downloaded at the Torrance sales office by Retailer 1 were shipped
21 by common carrier to California customers from this retailer's out-of-state inventory located in
22 Memphis, Tennessee, or from the California inventory of the retailer's vendors. Based on that finding,
23 the Department then asked Retailer 1 to begin reporting its local tax to the countywide pools. When
24 petitioner discovered it was no longer receiving a direct allocation of local tax for these sales, it filed
25 an appeal seeking reallocation of all local tax that had been allocated through the countywide pools
26 directly to petitioner.

27 In the absence of information regarding the actual amount of sales drop-shipped from
28 California inventory, the Department estimates that such sales represent 10 percent of the retailers'

1 sales to California customers, based on the results of an audit of a related retailer. Petitioner does not
2 dispute that estimate. The Department thus computes that: (1) for the period April 1, 2001, through
3 June 30, 2002, \$97,538 (10 percent of \$975,384) was correctly reported directly to petitioner by
4 Retailer 1 as local sales tax, and that \$877,846 ($\$975,384 - 97,538$) was local use tax, which should
5 have been reported to the countywide pools where the goods were shipped; and (2) for the period
6 July 1, 2002, through September 30, 2010, about \$590,529 ($\$492,106$ (10 percent of $\$4,921,062$
7 reported by Retailer 1) + $\$98,423$ (10 percent of $\$984,223$ reported by Retailer 2) of the local tax
8 reported was local sales tax, which should have been reported directly to petitioner, and that
9 $\$5,314,756$ ($\$5,905,285 - \$590,529$) was local use tax correctly reported to the countywide pools
10 where the goods were shipped. Therefore, the Department concludes that since Retailer 1 has
11 overstated the amount of local tax it reported directly to petitioner by $\$877,846$, a net deallocation of
12 about $\$287,317$ ($\$492,106$ (Retailer 1) + $\$98,423$ (Retailer 2) - $\$877,846$ (Retailer 1)) from petitioner
13 to the countywide pools is warranted.

14 The Department asserts that, with the exception of sales for which the property was drop-
15 shipped from the inventory of the retailers' California vendors, the retailers' sales occurred outside
16 California because title passed outside California at the time of shipment, meaning that the applicable
17 tax was use tax. (Cal. U. Com. Code, § 2401; see Cal. Code Regs., tit. 18, § 1628, subd. (b)(3)(D).)
18 The Department maintains that the terms and conditions of sale were as provided on the retailers'
19 websites, which indicate that title passed from the retailers to the customers at the time of shipping. In
20 addition, the Department indicates that the shipping terms were "FOB Memphis."

21 Petitioner's primary contention is that the sales for goods shipped by common carrier to
22 California customers from Tennessee were subject to the local sales tax. In support, petitioner asserts
23 that Revenue and Taxation Code section 7205, subdivision (a), contains a conclusive presumption that
24 all sales negotiated at a California place of business are consummated at that location and that
25 California Code of Regulations, title 18, section (Regulation) 1802, subdivision (a) is consistent with
26 this interpretation. Petitioner further contends that subdivision (a)(2)(A) of Regulation 1620 provides
27 that participation by a California place of business is sufficient to justify imposition of the sales tax
28 even with respect to sales involving shipment of property from out of state. Also, petitioner, while not

1 conceding this primary argument, contends that the shipping terms stated on an invoice do not
2 necessarily represent evidence of the terms of the contract of sale. Petitioner further asserts that certain
3 statements in the Annual Reports of the retailers' parent company should be given more weight than
4 the contract or shipping terms.

5 Petitioner appears to argue that the rules for determining whether the applicable tax is sales tax
6 or use tax are different for local tax imposed under the Bradley-Burns Uniform Local Sales and Use
7 Tax Law than for state tax imposed under the Sales and Use Tax Law. In that regard, petitioner asserts
8 that the local *sales* tax rules of section 7205 control whether the local tax is sales tax or use tax.
9 Petitioner is mistaken; section 7205 explicitly applies *if* the local tax is sales tax. That is, we must first
10 determine that the local tax *is* a sales tax before section 7205 is relevant. Similarly, petitioner's
11 reliance on Regulation 1620, subdivision (a)(2)(A) is mistaken. Subdivision (a)(1) of Regulation 1620
12 explicitly states, "If title to the property sold passes to the purchaser at a point outside this state, or if
13 for any other reason the sale occurs outside this state, the sales tax does not apply, regardless of the
14 extent of the retailer's participation in California in relation to the transactions."

15 Also, we find unpersuasive petitioner's assertion that the shipping terms stated on an invoice do
16 not necessarily represent evidence of the terms of the contract of sale. While petitioner is correct that
17 the provisions of UCC section 2401 look to the terms of a contract for title passage, these provisions
18 do not focus only on a document called a "contract" and thus apply even when the document is called
19 something else (e.g. agreement or invoice). Moreover, the title passage rules of UCC section 2401
20 apply in the absence of an "explicit agreement" to pass title at a *prior* time. In this case, the terms and
21 conditions on each retailer's website contain the explicit provision, "Title to items being purchased
22 passes from [the retailer] to purchaser at the time of shipping." Since it is undisputed that the subject
23 goods shipped from the retailers' warehouse in Tennessee, for purposes of the Sales and Use Tax Law,
24 the sales did not occur in California. Accordingly, neither the state sales tax nor the local sales tax
25 applies to the sales at issue. Last, petitioner's assertion that the Annual Report statements should be
26 given more weight for sales tax purposes than the contract or shipping terms is also misplaced. The
27 Annual Report statements neither reflect the terms of a contract between the retailer and its customers,
28 nor indicate the actual location of the goods at the time of title passage.

1 In summary, we find that petitioner has not shown that any of the retailers' sales, other than
2 those for which the property was drop-shipped from their vendors' California inventory, occurred in
3 California. Therefore, these sales were subject to local use tax, rather than local sales tax.
4 Accordingly, excluding the sales drop-shipped from California inventory, we find there is no basis for
5 reallocation of the local tax reported to the various countywide pools; however, there is a basis for
6 deallocating \$877,846 (90 percent of \$975,384) of the local tax reported by Retailer 1 directly to
7 petitioner for the period April 1, 2001, through June 30, 2002.

8 **RESOLVED ISSUE**

9 With regard to the sales drop-shipped from California inventory of the retailer's vendors, we
10 find that the local sales tax should be directly allocated to petitioner. The Department determined that
11 about \$492,106 (10 percent of \$4,921,062) was incorrectly allocated by Retailer 1 to the various
12 countywide pools for the period July 1, 2002, through September 30, 2010, and about \$98,423 (10
13 percent of \$984,223) was incorrectly allocated by Retailer 2 to the various countywide pools for the
14 period October 1, 2004, through September 30, 2010. We find that approximately \$590,529 (\$492,106
15 + \$98,423) should be reallocated directly to petitioner, and we recommend granting the petition as to
16 this amount.⁴

17 **OTHER DEVELOPMENTS**

18 None.

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20 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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28 ⁴ We note that, for the period April 1, 2001, through June 30, 2002, Retailer 1 allocated all of its local tax directly to petitioner, and we find that \$97,538 (10 percent of \$975,384) was properly allocated to petitioner. That allocation represents a matter that is, in effect, resolved because there is no dispute regarding the allocation of \$97,538.

1 parties agree to pass title after the retailers complete their performance with reference to physical
2 delivery and where the retailers are not required to deliver the goods at destination, title will actually
3 pass, and the sale will actually occur, upon tender of the goods to the common carrier. (*Ibid.*)

4 In summary, we find that petitioner has not shown that any of the subject sales occurred in
5 California. Since the disputed sales clearly occurred outside California pursuant to the explicit title
6 passage provision (and even in the absence of such an explicit provision, all will be regarded as having
7 occurred in Tennessee pursuant to the default provisions of the UCC), they are subject to local use tax,
8 rather than local sales tax. Accordingly, excluding the sales drop-shipped from California, we find
9 that: (1) there is no basis for reallocation of the local tax for the period July 1, 2002, through
10 [March 31, 2010¹⁸], as the local use tax was allocated correctly; and (2) there is a basis for
11 deallocating the local tax for the period April 1, 2001, through June 30, 2002, as the local use tax was
12 incorrectly allocated to petitioner.

13 Recommendation

14 We recommend that ten percent of the disputed local tax be reallocated to petitioner, resulting
15 in a deallocation from petitioner to the various countywide pools of about \$311,147 (the specific
16 amount to be calculated by the Department as explained in footnotes number 5 and 6, above), and the
17 petition otherwise be denied.

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19 _____ June 9, 2010
Trecia M. Nienow, Tax Counsel IV Date

20 Attachment: Exhibits 1 - 4
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28 [¹⁸This footnote was not in the original D&R and is added to note the correction of an error. The original D&R stated this date as December 31, 2009, while the correct date is March 31, 2010, as noted in the revised text.]