Rulemaking File Index

Title 18. Public Revenue

Proposed Sales and Use Tax Regulation 1585 Petition

Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices,

1. *Original Petition dated February 18, 2015 from Mr. Daniel Hattis*

2. *Acknowledgement Letter to Mr. Hattis, February 26, 2015*

3. *Chef Counsel Memo, Item J1 March 12, 2015*

   The following items are exhibited:

   - Chief Counsel Memo dated March 12, 2015
   - Original Petition
   - Acknowledgement Letter to Mr. Hattis, February 26, 2015
   - Petition, January 14, 2011
   - Mr. Hattis's email to Mr. Bennion February 25, 2016
   - Formal Issue Paper 97-017

4. *Public Comment from Jai Sookprasert, Assistant Director of Governmental Relations, California School Employees Association, January 26, 2011*

5. *Reporter's Transcript, Chief Counsel Matters, Item J1, March 26, 2015*

6. *Notice to OAL*

   - Form 400 and notice, April 24, 2015
   - CA Regulatory Notice Register 2015, Volume No. 17-Z

7. *Denial Letter, April 27, 2015*

8. *Interested Parties Letter Dated April 27, 2015*

BEFORE THE CALIFORNIA BOARD OF EQUALIZATION

In re Petition to the California Board of Equalization for Repeal of Cal. Code Regs. tit. 18, § 1585

PETITION TO THE CALIFORNIA BOARD OF EQUALIZATION FOR REPEAL OF CAL. CODE REGS. TIT. 18, § 1585

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Attorneys for Petitioner Consumer Jenny Lee

I. INTRODUCTION

Pursuant to Gov't Code § 11340.6, petitioner consumer Jenny Lee ("Petitioner") hereby petitions the California Board of Equalization ("CBOE") for the repeal of the Cal. Code Regs. tit. 18, §1585 ("Regulation 1585"). Petitioner purchased two mobile phones directly from AT&T, and was charged excessive sales tax on the phones at the point of sale. Pursuant to Regulation 1585, the sales tax was calculated not on the actual amount AT&T received for the transaction, but instead on a much higher fictitious "unbundled sales price," a term invented by the CBOE. The CBOE exceeded its authority in the promulgation of Regulation 1585 because the regulation is inconsistent with the California Revenue and Tax Code's requirement that all sales taxes are to be calculated based on the "gross receipts" retailers actually receive at the point of sale. *See* Rev. & Tax. Code §§ 6012 and 6051. The Regulation wrongly and unlawfully redefines "gross receipts" to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction. Regulation 1585 must be repealed because the Administrative Procedure Act forbids the enforcement of regulations that exceed the authority granted by, or that are in conflict with, their purportedly authorizing statute. *See* Gov't Code §§ 11342.1 and 11342.2.

II. INTEREST OF PETITIONER

Petitioner is an interested person because she paid excessive sales tax on mobile phones purchased from AT&T, where AT&T explicitly relied on Regulation 1585 in charging the tax. On December 27, 2012, Ms. Lee purchased an iPhone 5 for $199.99 from AT&T's retail store located at 3251 20th Ave., Suite 240, San Francisco, CA. On December 18, 2013, Ms. Lee purchased an LG Optimus G Pro mobile phone for $99.99 from the same store. *See* receipts at Exhibit A. Ms. Lee purchased each of the phones as part of a bundled transaction where she was required to sign a two-year contract with AT&T as her wireless carrier.

Pursuant to Regulation 1585, AT&T charged Ms. Lee sales tax of $55.25 on the iPhone, and $38.50 on the LG phone, based on what the CBOE calls the "unbundled sales price" of the phones. Ms. Lee would have paid sales tax of only $17.00 on the iPhone, and $8.75 on the LG phone, if the taxes had been based on the amount AT&T actually received, and she actually paid, at the point of sale. Ms. Lee overpaid sales tax on the transactions in the amount of $68.00, which is the difference between the taxes she did pay (based on the fictitious $649.99 and $439.99 prices), and the taxes she would have paid if not for Regulation 1585 (based on the true $199.99 and $99.99 prices).

On November 17, 2014, Ms. Lee filed a BOE-101 Claim for Refund with the CBOE requesting that the CBOE: (1) refund the $68.00 overpayment; (2) "ascertain" that Ms. Lee paid excessive sales tax; and (3) repeal Regulation 1585. *See* Exhibit B. On November 21, 2014, Ms. Lee received a written response from the CBOE denying her request. *See* Exhibit C. Ms. Lee is representative of millions of California consumers who have paid, and continue to pay, excessive sales taxes pursuant to the unlawful Regulation 1585.

III. ARGUMENT

Gov't Code § 11340.6 provides that any interested person may petition a California agency such as the CBOE to request the repeal of a regulation so long as the petition clearly and concisely states: "(a) The substance or nature of the regulation, amendment, or repeal requested, (b) The reason for the request, and (c) Reference to the authority of the state agency to take the action requested." Petitioner hereby petitions the CBOE to repeal Regulation 1585.

A. The substance or nature of the regulation, amendment, or repeal requested

The CBOE wrongly promulgated in Regulation 1585 that the "gross receipts" from mobile phone sales be measured by the "unbundled sales price" of the phone, even when the actual price charged and received by the retailer is significantly lower. Rev. & Tax. Code §§ 6012(a) defines

"gross receipts" as the total amount of money received by the retailer for the transaction. In Regulation 1585, the CBOE acknowledges that sales tax must be applied "to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction," but then unilaterally and unlawfully specifies that the bundled transaction be "measured by the unbundled sales price of that device." *See* Regulation 1585(b)(3).

Petitioner requests that the CBOE repeal Regulation 1585 because it is inconsistent with the plain meaning of the California Revenue and Taxation Code's requirement that sales tax be calculated based on the "gross receipts" retailers receive at the point of sale. In the alternative to the CBOE repealing Regulation 1585 in its entirety, Ms. Lee petitions the CBOE to repeal Sections (a)(3-4), (b)(3-6), and (c) of the Regulation.

B. The reason for the request

Ms. Lee is representative of millions of California consumers who have paid, and continue to pay, excessive sales taxes pursuant to the unlawful Regulation 1585. The CBOE denied Ms. Lee's BOE-101 Claim for Refund and told Ms. Lee that she has no standing to request a refund of sales tax from the CBOE, let alone to demand that the Regulation be repealed. *See* Exhibit B. This Gov't Code § 11340.6 Petition provides the only avenue remaining to Ms. Lee, short of a lawsuit, to demand a refund and the repeal of Regulation 1585.

Whatever its motives, an administrative agency such as the CBOE has no discretion to promulgate a regulation that is inconsistent with its governing statutes. *See Terhune v. Superior Court*, 65 Cal. App. 4th 864 (1998); *Pulaski v. California Occupational Safety & Health Standards Board*, 75 Cal. App. 4th 1315, 1341 (1999); *Transworld Sys., Inc. v. County of Sonoma*, 78 Cal. App. 4th 713, 717 (2000). The Administrative Procedure Act forbids the enforcement of regulations that exceed the authority granted by, or that are in conflict with, their purportedly authorizing statute. Regulations must "be within the scope of authority conferred in

accordance with the standards prescribed by other provisions of law." *See* Gov't Code § 11342.1. Regulations that "alter or amend the [governing] statutes or enlarge or restrict the agency's statutory power" are invalid. *California Beer & Wine Wholesalers Association v. Department of Alcoholic Beverage Control*, 201 Cal. App. 3d 100, 106-07 (1988).

The CBOE exceeded its authority when it promulgated Regulation 1585 because the regulation is inconsistent with the California Revenue and Taxation Code's requirement that all sales taxes are to be calculated based on the "gross receipts" retailers actually receive at the point of sale. *See* Rev. & Tax. Code §§ 6012 and 6051. Contrary to the clear language in the Tax Code, Regulation 1585 unlawfully redefines "gross receipts" -- and does so only with regard to mobile phones and other wireless telecommunication devices -- to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction.

C. Authority of the CBOE to repeal Regulation 1585

The CBOE has authority to promulgate regulations relating to the administration and enforcement of the Tax Code pursuant to Rev. & Tax. Code § 7051. Consequently, the CBOE also has authority to repeal such regulations.

IV. DEMAND

Pursuant to Gov't Code §11340.7, the CBOE has thirty days from the receipt of this Petition to set a hearing on this Petition to repeal Regulation 1585 in its entirety (or in the alternative to repeal Sections (a)(3-4), (b)(3-6), and (c)), or to explain in writing why the CBOE denies the Petition. If the CBOE does not provide a response to this Petition, Ms. Lee will file a declaratory relief action pursuant to Gov't Code §11350 to challenge Regulation 1585 as inconsistent with the Tax Code.

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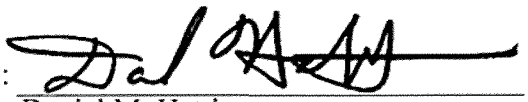
Petitioner looks forward to the CBOE's prompt response.

Dated: February 18, 2015

Respectfully submitted,

HATTIS LAW

By: 
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2300 Geng Road, Suite 200
Palo Alto, CA 94303
Telephone: (650) 980-1990

Attorneys for Petitioner Consumer Jenny Lee

EXHIBIT A

at&t

San Francisco Stonestown Retail Store
3251 20th Ave, Suite 240, AT&T Store
San Francisco, CA 94132
(415) 564-2171
Store No. S192 Register No. 41

Customer:
JENNY LEE
415-235-5851 (T)

69300 PHO IPHONE 5 16GB BLK 199.99
SER. NO. 013431001390824
Taxable Unit Value 649.99
ADDED 24 Months
CHANGED SIM: 89014103255422569328
CHANGED IMEI: 013431001390824
ADDED DATA PLAN UNL LTE IP
ACCOUNT NOTE 415-235-5851

Customer:
JENNY LEE
415-286-3200 (T)
DELETED IPHONE MSG UNL

Customer:
JENNY LEE
415-308-7721 (T)
ADDED Family Messaging UNL with

SUBTOTAL	199.99
TAX	55.25
TOTAL AMOUNT DUE	255.24
COMMITMENT SAVINGS -	$450.00
CORPORATE ACCESSORY DISCOUNT	$0.00
AMERICAN EXPRESS TENDERED	255.24
Acct No.	XXXXXXXXXXX1007
Auth No.	509970

CHANGE DUE 0.00

YOUR TOTAL SAVINGS $450.00

American Express
Acct No. XXXXXXXXXXX1007
Auth No. 509970
AMOUNT $255.24

I HAVE RECEIVED GOODS AND
SERVICES IN THE ABOVE AMOUNT

SIGN X _____

CASHIER: STEPHANIE T

XS192A07VSL9

12/27/2012 13:08:27
STORE COPY

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

RETURN INFORMATION
Return & restocking fee policy on back

Pursuant to California Sales Tax
Regulation 1585, tax on devices sold with
service are calculated based on the no
commit pricing.

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

at&t

San Francisco Stonestown Retail Store
3251 20th Ave, Suite 240, AT&T Store
San Francisco, CA 94132
(415) 564-2171
Store No. S192
OM Tablet No. 17

Customer:
JENNY LEE
415-308-7721 (T)

6053A	PHO LGE OPT G PRO E980	99.99
	SER. NO. 013520002278085	
	Taxable Unit Value 439.99	
40954	SIM UICC-G 3FF MICRO	0.00
	SER. NO. 89014104276557589740	
	Taxable Unit Value 0.00	
76304	DECLINED INSURANCE	0.00
	1 @ 0.00 No Discount Available	

ADDED 24 Months
CHANGED SIM: 89014104276557589740
CHANGED IMEI: 013520002278085
ADDED DataPro 3GB for Smartphone
ACCOUNT NOTE 415-308-7721

SUBTOTAL	99.99
TAX	38.50
TOTAL AMOUNT DUE	138.49
COMMITMENT SAVINGS -	$340.00
CORPORATE ACCESSORY DISCOUNT	$0.00
VISA TENDERED	138.49
Acct No.	XXXXXXXXXXXX5056
Auth No.	052158

CHANGE DUE 0.00

YOUR TOTAL SAVINGS $340.00

Visa
Acct No. XXXXXXXXXXXX5056
Auth No. 052158
AMOUNT $138.49

I HAVE RECEIVED GOODS AND
SERVICES IN THE ABOVE AMOUNT

CASHIER: VINCENT H

XS192IES83F9

12/18/2013 18:58:46
STORE COPY

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

RETURN INFORMATION
Return & restocking fee policy on back

Pursuant to California Sales Tax Regulation 1585, tax on devices sold with service are calculated based on the no commit pricing.

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?

EXHIBIT B

HATTIS LAW

Daniel M. Hattis, Esq.
2300 Geng Road, Suite 200
Palo Alto, CA 94303
dan@hattislaw.com
T – 650.980.1990
F – 650.989.4189

November 17, 2014

State Board of Equalization
P.O. Box 942879
Sacramento, CA 94279

Re: My Client: Jenny Lee
BOE-101 Claim for Refund
Overpayment of Sales Tax on Mobile Phone

To Whom It May Concern:

Please find enclosed my above-referenced client's claim for a refund of $68.00 for overpaid sales tax on mobile phones purchased on December 27, 2012 and December 18, 2013.

Very truly yours,

Daniel M. Hattis

Enclosures: BOE-101, Exhibit A, Copy of Sales Receipts

BOE-101 (FRONT) REV. 7 (11-09)

CLAIM FOR REFUND OR CREDIT

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

(Instructions on back)

NAME OF TAXPAYER(S) OR FEEPAYER(S)
Jenny Lee

TAXPAYER'S OR FEEPAYER'S ACCOUNT NO.

GENERAL PARTNER *(if applicable)*

TAXPAYER'S OR FEEPAYER'S SOCIAL SECURITY NUMBER(S)* OR FEDERAL EMPLOYER IDENTIFICATION NUMBER

According to

- ☑ Chapter 7, Article 1, of the California Sales and Use Tax Law, and where applicable, Uniform Local Sales and Use Tax Ordinances and the Transit District Transactions (Sales) and Use Tax Ordinances, or
- ☐ Chapter 6, Article 1, of the California Use Fuel Tax Law, or
- ☐ Chapter 8, Article 1 and 2, of the Diesel Fuel Tax Law,
- ☐ Other _____ *(please specify the applicable tax law or fee program)*

the undersigned hereby makes claim for refund or credit of $ 68.00 *(may be left blank)*, or such other amounts as may be established, in tax, interest and penalty in connection with:

☐ Return(s) filed for the period _____ to _____

☐ Determination(s) dated _____ and paid _____

☑ Other *(describe fully)*

Ms. Lee's overpayment of mobile phone sales taxes paid on 12/27/12 and 12/18/13, because CBOE Regulation 1585, upon which the AT&T relied in charging her sales tax on inflated and fictitious transaction amounts, is unlawful.

The overpayment described above was caused by

See attached "Exhibit A"

Supporting Documentation:

☑ is attached
☐ will be provided upon request

BUSINESS NAME

SIGNED BY

DATE SIGNED
11/17/2014

PRINT NAME OF SIGNATORY
Daniel M. Hattis

CONTACT PERSON *(if other than signatory)*

TITLE OR POSITION
Attorney for Ms. Lee

TELEPHONE NUMBER
(650) 980-1990

TITLE OR POSITION OF CONTACT PERSON

TELEPHONE NUMBER
( )

☐ *Credit interest is available under certain circumstances. If you would like to be considered for credit interest, please check here.*

*See BOE-324-GEN, Privacy Notice, regarding disclosure of the applicable social security number.

FOR BOE USE ONLY

Case ID No. _____

EXHIBIT A
Form BOE-101
Jenny Lee, SSN

On December 27, 2012, Ms. Lee purchased an iPhone 5 mobile phone from AT&T's retail store located at 3251 20th Ave., Suite 240, San Francisco, CA, for $199.99. On December 18, 2013, Ms. Lee purchased an LG Optimus G Pro mobile phone from the same store for $99.99. *See* attached receipts. Ms. Lee purchased each of the mobile phones as part of a bundled transaction where she was required to sign a two-year contract with AT&T as her wireless carrier.

Pursuant to California Board of Equalization ("CBOE") Regulation 1585, AT&T charged Ms. Lee sales tax of $55.25 on the iPhone 5, and $38.50 on the LG phone, based on what the CBOE calls the "unbundled sales price" of the phones. Ms. Lee would have paid sales tax of only $17.00 on the iPhone 5, and $8.75 on the LG phone, if the taxes had been based on the amount AT&T actually received, and she actually paid, at the point of sale. Ms. Lee believes she overpaid sales tax on the transactions and demands a refund in the amount of $68.00, which is the difference between the taxes she actually paid (based on the fictitious $649.99 and $439.99 prices), and the taxes she should have paid (based on the true $199.99 and $99.99 prices she was actually charged for the phones).

Ms. Lee is entitled to the refund because Regulation 1585, which AT&T explicitly relied upon in charging the excess tax, is unlawful. Regulation 1585 directly conflicts with the California Revenue and Tax Code's ("Tax Code") explicit requirement that sales taxes be limited to the "gross receipts" retailers receive at the point of sale. *See* Rev. & Tax. Code § 6051. The Tax Code defines gross receipts as the total amount of money received by the retailer for the transaction. *Id.* § 6012. Under Regulation 1585, the CBOE wrongly redefined "gross receipts" with regard to mobile phone sales to be measured by the "unbundled sales price" of the phone (*e.g.*, $649.99), even when the actual price paid to the retailer is significantly lower (*e.g.*, $199.99). Under Regulation 1585 retailers are directed to pay (and are permitted to pass through to consumers) taxes on entirely imaginary transaction amounts never actually paid to the retailers, in direct violation of Rev. & Tax. Code §§ 6051 and 6012.

CBOE exceeded its authority in creating Regulation 1585. The CBOE may only "prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement" of the Tax Code. *Id.* § 7051. The CBOE cannot invent new taxes out of whole cloth that directly conflict with the clear language of the Tax Code itself.

Based on the foregoing, Ms. Lee demands a refund from the CBOE in the amount of $68.00, which is the excess sales tax she paid, and the CBOE received, under the unlawful Regulation 1585 sales tax scheme. Ms. Lee demands that pursuant to Rev. & Tax. Code § 6901.5, the CBOE "ascertain" that she paid sales taxes computed on amounts (*i.e.*, $649.99 and $439.99) that were in excess of the taxable amounts (*i.e.*, $199.99 and $99.99). She further demands that the CBOE repeal Regulation 1585.

EXHIBIT C

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0039
TELEPHONE (916) 324-3017
FAX (916) 445-2249 OR 324-0147
Roslyn.Nera@boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Orange County

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

November 20, 2014

Daniel M. Hattis, Esq.
2300 Geng Rd., Suite 200
Palo Alto, CA 94303

Re: Jenny Lee
Request for Refund
Postmarked: November 17, 2014
Received: November 19, 2014

Dear Claimant:

Your claim for refund postmark dated November 17, 2014 and received in our office on November 19, 2014; in which you request a refund of $68.00 for sales tax paid to AT&T has been referred to this office for consideration.

Under California law, a refund of an overpayment of sales tax may be made only to the firm or individual who paid the tax to this Board. Your recourse, therefore, is to contact AT&T. They, in turn, may file a claim for refund with us, supported by the proper documentation. Any refund due would be issued to the seller with the provision that it passed on to you.

We regret that we cannot be of direct assistance to you in this matter.

Thank you for your cooperation.

Sincerely,

Roslyn D. Nera
Senior Tax Auditor
Audit Determination & Refund Section

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
916-445-2130 • FAX 916-324-3984
www.boe.ca.gov

SEN. GEORGE RUNNER (RET.)
First District, Lancaster

FIONA MA, CPA
Second District, San Francisco

JEROME E. HORTON
Third District, Los Angeles County

DIANE L. HARKEY
Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

February 26, 2015

Subject: Petition to Repeal Sales and Use Tax Regulation 1585

Dear Mr. Hattis,

On Monday, February 23, 2015, the Legal Department received your petition filed on behalf of Ms. Jenny Lee, pursuant to Government Code section 11340.6, requesting the repeal of California Code of Regulations, title 18, section (Regulation) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices.*

We appreciate that Ms. Lee agreed to an open-ended extension of the 30-day period in Government Code section 11340.7 on the conditions that the extension is revocable by Ms. Lee on 30 days written notice to the Board and the Board is required to schedule a hearing on the petition within 30 days of Ms. Lee's notice of revocation, as indicated in your February 25, 2015, email.

Board staff anticipates scheduling a hearing on the petition during the Board's March 25-26, 2015, meeting in Sacramento. The public agenda notice (PAN) for that meeting will be available on the Board's website at www.boe.ca.gov at least 10 days prior to that meeting. The PAN will include a link to a Chief Counsel Memorandum setting forth the Legal Department's recommendation regarding the petition.

If you have any questions or need more information, please contact Bradley Heller, Tax Counsel IV, at 916-323-3091.

Sincerely,

Richard Bennion
Regulations Coordinator

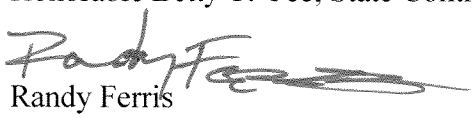
State of California

Board of Equalization
Legal Department-MIC:83
Office of the Chief Counsel
(916) 445-4380
Fax: (916) 322-0341

Memorandum

To: Honorable Jerome E. Horton, Chairman
Senator George Runner, Vice Chair
Honorable Fiona Ma, CPA, Second District
Honorable Diane L. Harkey, Fourth District
Honorable Betty T. Yee, State Controller

Date: March 12, 2015



From: Randy Ferris
Chief Counsel

Subject: Board Meeting, March 25-26, 2015
Chief Counsel Matters – Item J. Rulemaking
Petition to Repeal Sales and Use Tax Regulation 1585,
Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices

On Monday, February 23, 2015, the Legal Department received a petition dated February 18, 2015 (attached hereto with related correspondence dated March 7, 2015), from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting the repeal of California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, the repeal of subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition seeks to repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserts that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

This matter is scheduled for the Board's consideration at the March 25-26, 2015, Board meeting on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process to repeal or amend the regulation by ordering publication of a notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested repeal or amendments in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition in its entirety because, as explained below, Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. In staff's view, the petition appears to be based on petitioner's misinterpretation of current law.

This memorandum sets forth: (1) relevant background information pertaining to the drafting and adoption of Regulation 1585 and to staff's response to the petition; (2) a discussion of and staff's response to the petition; and (3) staff's recommendation.

I. Background Information

A. Sales and Use Tax

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)

When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg. 1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms "sales price" and "gross receipts" so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

> (a) "Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
> (b) The total amount of the sale or lease or rental price includes all of the following:
> (1) Any services that are a part of the sale.
> (2) All receipts, cash, credits and property of any kind.
> (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board's long-standing interpretation of RTC section 6012 is that "'[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or

sale costs." (See, e.g., Sales and Use Tax Annotation[1] 295.1690 (8/16/78).) Also, the California court's and the Board's long-standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88 [gross receipts included non-mandatory tips paid to retailer's waitresses for serving food to the extent waitresses agreed to credit the tips against retailer's obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer's coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

B. Drafting and Adoption of Regulation 1585

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark-up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long-standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

Board staff discussed its first formal draft of Regulation 1585 in Formal Issue Paper 97-017 (dated current as of December 17, 1997), which Board staff submitted to the Board for consideration at its January 6, 1998, Business Taxes Committee (BTC) meeting. (For your reference, the formal issue paper is also attached hereto.) During the January 6, 1998, BTC meeting, the wireless telecommunications industry indicated that it still had some concerns about the specific language staff used to prescribe the application of tax to bundled and unbundled transactions in staff's first formal draft of Regulation 1585. The wireless telecommunications industry also indicated that it had substantive objections to staff's proposed application of tax to "carrier restricted transactions" and "retail utilities transactions" in subdivisions (a)(4) and (5), and (b)(2) and (3) of staff's first draft of the Regulation. Therefore, the Business Taxes Committee approved publication of a second January 6, 1998, version of Regulation 1585, which included some changes that both staff and the wireless telecommunications industry agreed to, and advised industry to continue to express whatever concerns they still had regarding the specific regulatory language and provide

[1] 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. (Reg. 5700, subds. (a)(1), (c)(2).)

specific alternative language for the Board's consideration. (January 6, 1998, Business Taxes Committee meeting minutes.)

The Board subsequently published the January 6, 1998, draft of Regulation 1585, and held a public hearing regarding the adoption of that draft on April 30, 1998. Several written comments were received from the wireless telecommunications industry before the public hearing and several comments were made by industry representatives during the public hearing. "The Board, as a result of the written and oral comments discussed above, concluded that, as the published version was an initial draft published to get the regulation process going, further work would be needed. Thereupon the Board closed the Public Hearing, without approving specific changes, and ordered staff to work with industry to develop a final version to be presented to the Board . . . ." (Final Statement of Reasons, p. 4.)

The Board's reconsideration of Regulation 1585 was subsequently postponed twice while Board staff and industry worked together during several informal meetings. Finally, on August 18, 1998, Board staff submitted a revised draft of Regulation 1585 for the Board's consideration during its August 27, 1998, meeting, which addressed the majority of industry's drafting issues and no longer recommended that Regulation 1585 include the provisions regarding "carrier restricted transactions" and "retail utilities transactions." On August 27, 1998, the Board gave staff direction regarding the remaining drafting issues. For example, "[i]n the August 18, 1998 draft, the staff had recommended that a markup of 30% . . . be used [to determine whether a device was sold at a fair retail selling price]; industry proposed a markup of 6%. . . . the Board compromised, amending the staff draft to specify a markup of 18%." (Final Statement of Reasons, p. 6.) Also, the Board added a new provision stating that "the measure of tax for unbundled transactions made prior to October 1, 1995 was the actual consideration received from the end-use customer. Under Revenue and Taxation Code section 7051, the Board concluded that October 1 was a proper date on the grounds that (1) the date, not capable of being determined with exactitude, should be the start of a tax period, and (2) this was the date that the Board had issued a Notice to industry as to how tax should be applied to sales of devices in bundled transactions, and the Board concluded that such transactions had been reported under this formula ever since." (Final Statement of Reasons, p. 7.)

On August 27, 1998, the Board also approved the changes the Board directed staff to make to the August 18, 1998, draft of Regulation 1585. A new draft, dated August 31, 1998, was created. The August 31, 1998, draft of Regulation 1585 was provided to the interested parties on September 15, 1998, and the interested parties were given an additional 15 days in which to submit any remaining comments they had regarding the proposed language. However, no written or oral comments were received. Consequently, the Board Members unanimously voted to adopt the August 31, 1998, version of Regulation 1585 during the Board's meeting on October 15, 1998. (Final Statement of Reasons, p. 8.)

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications

service provider for utility service for a period greater than one month as a condition of that sale." The current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

C. Regulation 1671.1, Discounts, Coupons, Rebates, and Other Incentives

The Board has also adopted Regulation 1671.1, *Discounts, Coupons, Rebates, and Other Incentives*, to generally prescribe the measure of tax when retailers receive consideration from third parties for making discounted sales of tangible personal property to consumers. Regulation 1671.1 does not currently apply to sales of wireless telecommunication devices under Regulation 1585 because the specific provisions of Regulation 1585, not the general provisions of Regulation 1671.1, are controlling for the wireless telecommunication industry. However, it should be noted that, while not currently applicable, Regulation 1671.1, subdivision (c)(3)(A) provides that "when a retailer enters into an oral or written contract with a manufacturer or other third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products in exchange for a certain payment of a like amount from the contracting party . . . , such payments received by the retailer are part of the taxable gross receipts or sales price of the sales."

D. The Court's Deference to the Board's Regulations

The California Supreme Court has previously reviewed challenges to the Board's interpretations of tax laws, both with and without the adoption of regulations. In *Yamaha Corporation of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 10-11 (hereafter *Yamaha*), the California Supreme Court explained that:

> It is a "black letter" proposition that there are two categories of administrative rules and that the distinction between them derives from their different sources and ultimately from the constitutional doctrine of the separation of powers. One kind – quasi-legislative rules – represents an authentic form of substantive lawmaking: Within its jurisdiction, the agency has been delegated the Legislature's lawmaking power. [Citations omitted.] Because agencies granted such substantive rulemaking power are truly "making law," their quasi-legislative rules have the dignity of statutes. When a court assesses the validity of such rules, the scope of its review is narrow. If satisfied that the rule in question lay within the lawmaking authority delegated by the Legislature, and that it is reasonably necessary to implement the purpose of the statute, judicial review is at an end.

In *Yamaha,* the Court also quoted its earlier case, *Wallace Berrie & Company v. State Board of Equalization* (1985) 40 Cal.3d 60, 65, which similarly held that:

> "'[I]n reviewing the legality of a regulation adopted pursuant to a delegation of legislative power, the judicial function is limited to determining whether the regulation (1) is "within the scope of the authority conferred" [citation] and (2) is "reasonably necessary to effectuate the purpose of the statute" [citation].' [Citation.] 'These issues do not present a matter for the independent judgment of an appellate tribunal; rather, both come to this court freighted with [a] strong presumption of regularity . . . .' [Citation.] Our inquiry necessarily is confined to the question whether the classification is 'arbitrary, capricious or [without] reasonable or rational basis.' . . ." (*Yamaha*, at p. 11.)

In *Yamaha,* the Court also said that judicial review is more deferential when the Board has adopted a quasi-legislative regulation, pursuant to the Administrative Procedure Act, codifying its interpretation of a statute (*Yamaha*, p. 13), and that an administrative interpretation in such a regulation "will be accorded great respect by the courts and will be followed if not clearly erroneous." (*Yamaha*, at p. 7.)

Furthermore, the California Supreme Court has previously rejected arguments that a Board regulation is invalid simply because it does not apply to different, but comparable, types of transactions. The Court affirmed that, to prevail against such an argument, the Board only needs to establish that the regulation is "not arbitrary, capricious, or without a rational basis." (*Western States Petroleum Association v. Board of Equalization* (2013) 57 Cal.4th 401, 421.)

E. Yabsley v. Cingular Wireless LLC & Loeffler v. Target Corporation

In *Yabsley v. Cingular Wireless, LLC* (Santa Barbara County Superior Court Case No. 01221332, Second Dist. Ct. of Appeal Case No. B198827, and Supreme Court Case No. S176146) (hereafter *Yabsley*), Cingular advertised that it would sell a cellular phone by itself for $299.99 and that it would sell the same cellular phone for 50 percent less or $149.99 in a bundled transaction with a Cingular wireless calling plan. The plaintiff purchased the cell phone in a bundled transaction with the wireless services, and, as a result, Cingular collected sales tax reimbursement from plaintiff measured by the unbundled price of the phone, based on Regulation 1585. In addition, Cingular did so without expressly informing the plaintiff prior to the sale that the tax would be based on the unbundled price of the phone. However, the amount of tax reimbursement was shown on the sales invoice furnished to the plaintiff at the time of sale.

The plaintiff alleged that Cingular engaged in unfair competition and misleading advertising in violation of Business and Professions Code sections 17200 and 17500. Cingular argued that its application of the sales tax to its sale of the cell phone was specifically authorized under the Board's regulation, so it could not be held liable for engaging in unfair business practices. The trial court agreed, granting Cingular's demurrer without leave to amend. The Court of Appeal also agreed, ruling that the Board's regulations have the force and effect of law; therefore, business activities permitted by the Board's regulation could not be unlawful or unfair. The Court of Appeal's opinion was published on August 18, 2008, as 165 Cal.App.4th 1526.

On September 17, 2008, however, the court vacated its opinion at the request of the California Attorney General, who had not been served with the briefs as required by applicable law. After briefing resumed, the Attorney General filed an *amicus* brief reflecting the Department of Justice's (DOJ's) *own* position that consumer protection laws could be used to adjudicate matters relating to sales taxes. The Board authorized the Legal Department to file an *amicus* brief opposing the position taken by the DOJ as contrary to the Board's regulations. Subsequently, the court issued an opinion affirming its previous ruling and also concluding that consumer protection statutes could not be used to adjudicate tax issues. The court's opinion was based in part on the reasoning in the Court of Appeal's recent decision, at the time, in *Loeffler* v. *Target Corporation* (2009) 173 Cal.App.4th 1229 (hereafter *Loeffler*), another case brought under consumer protection statutes challenging Target's collection of sales tax reimbursement on sales of hot coffee "to go," that such consumer protection suits regarding tax issues were barred by article XIII, section 32, of the California Constitution. The Court of Appeal's second *Yabsley* opinion was published on August 19, 2009, as 176 Cal.App.4th 1156.

Subsequently, the California Supreme Court granted review of *Yabsley*, but deferred its review pending its consideration of the related consumer protection issues in *Loeffler* (S1723972); and the Court of Appeal's second published opinion was depublished, pursuant to Rule 8.1105 of the California Rules of Court, as a procedural result of the grant of review. Then, the California Supreme Court decided *Loeffler* (2014) 58 Cal.4th 1081, 1092, holding that the RTC "provides the exclusive means by which plaintiffs' dispute over the taxability of a retail sale may be resolved and that their current lawsuit is inconsistent with tax code procedures. . . . [T]he consumer protection statutes under which plaintiffs brought their action cannot be employed to avoid the limitations and procedures set out by the Revenue and Taxation Code." Therefore, the California Supreme Court dismissed its review of *Yabsley* without expressly ordering the Court of Appeal's 2009 opinion in *Yabsley* to be re-published, so the Court of Appeals decision in *Yabsley* became final, but its 2009 opinion in *Yabsley* is still depublished today.[2]

F. Legislative Efforts to Change the Measure of Tax Regarding Sales of Wireless Devices

The Legislature is aware of Regulation 1585 and how it applies to bundled transactions involving sales of wireless telecommunication devices. From the 2001-2002 legislative session through the current legislative session, the following four bills were considered, but none were approved, that would have added section 6012.4 to the Revenue and Taxation Code to provide that "'gross receipts' and 'sales price' from the retail sale of a wireless [telecommunication or communication] device shall be limited to the amount charged for the sale of the wireless telecommunication device when that device is sold in a bundled transaction":

- Assembly Bill No. (AB) 2691 (2013-2014 session) – held in the Assembly Revenue and Taxation Committee;
- Senate Bill No. 1086 (2011-2012 session) – failed passage in the Senate Committee on Governance and Finance;
- AB 279 (2011-2012 session) – held in the Assembly Revenue and Taxation Committee; and
- AB 2320 (2005-2006 session) – held in the Assembly Revenue and Taxation Committee.

[2] The Court of Appeal's unpublished 2009 opinion in *Yabsley* is discussed in order to provide relevant historical background information. It is not being cited as precedent.

Board staff's April 29, 2014, Legislative Bill Analysis of the most recent bill, AB 2691, included staff's estimate that the enactment of RTC section 6012.4 would result in the annual loss of approximately $383 million in state and local sales and use tax revenue.

II. Discussion of the Petition

The petition requests that the Board repeal Regulation 1585 or, alternatively, that the Board repeal subdivisions (a)(3) and (4) (defining bundled transaction and unbundled sales price), (b)(3) through (6) (regarding the application of tax to bundled transactions, activation fees, consignment or sales and return transactions, and sales at less than 50 percent of cost), and (c) (regarding bad-debt deductions) of Regulation 1585. The petition seeks to repeal the regulation or portions of the regulation because petitioner asserts that the regulation is inconsistent with the statutory definition of "gross receipts" in RTC section 6012 and, therefore, violates Government Code sections 11342.1, which requires that an enforceable regulation be within the scope of the adopting agency's rulemaking authority, and 11342.2, which requires that a regulation be "consistent and not in conflict with the statute" it is implementing, interpreting, or making specific and be reasonably necessary to effectuate the purpose of the statute.

The petition generally alleges that the Board "exceeded its authority in the promulgation of Regulation 1585 because the regulation is inconsistent with the California Revenue and Taxation Code's requirement that all sales taxes are to be calculated based on the 'gross receipts' retailers actually receive at the point of sale. See Rev. & Tax. Code §§ 6012 and 6051. The [r]egulation wrongly and unlawfully redefines 'gross receipts' to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction." (Petition, p. 2.)

The petition also more specifically alleges that the Board "wrongly promulgated in Regulation 1585 that the 'gross receipts' from mobile phone sales be measured by the 'unbundled sales price' of the phone, even when the actual price charged and received by the retailer is significantly lower. Rev. & Tax. Code §[] 6012(a) defines 'gross receipts' as the total amount of money received by the retailer for the transaction. In Regulation 1585, the [Board] acknowledges that sales tax must be applied 'to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction,' but then unilaterally and unlawfully specifies that the bundled transaction be 'measured by the unbundled sales price of the device.' *See* Regulation 1585(b)(3)." (Petition, pp. 3-4.) The petition further states that "[c]ontrary to the clear language in the Tax Code, Regulation 1585 unlawfully redefines 'gross receipts' – and does so only with regard to mobile phones and other wireless telecommunication devices – to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction." (Petition, p. 5.)

In addition, the petition explains why the petitioner filed the petition. The petition states that "[o]n December 27, 2012, [petitioner] purchased an iPhone 5 for $199.99" and "[o]n December 18, 2013, [petitioner] purchased an LG Optimo G Pro mobile phone for $99.99" from the same AT&Ts retail store in San Francisco, and that in both instances petitioner "purchased the phones as part of a bundled transaction where she was required to sign a two-year contract with AT&T as her wireless carrier." (Petition, p. 2.) Petitioner's receipt from the first transaction shows that petitioner paid "$199.99" for the iPhone 5 because petitioner received a $450 "commitment savings" credit on the $649.99 sales price of the iPhone 5 before the credit, and shows that petitioner paid the retailer "$55.25" of sales tax reimbursement on the $649.99 unbundled sales price of the iPhone 5 before the credit. (Exhibit A to Petition.) Petitioner's receipt from the

second transaction shows that petitioner paid "$99.99" for the LG Optimo because petitioner received a $340 "commitment savings" credit on the $439.99 sales price of the LG Optimo before the credit, and shows that petitioner paid the retailer "$38.50" of sales tax reimbursement on the $439.99 unbundled sales price of the LG Optimo before the credit. (Exhibit A to Petition.) Petitioner alleges she "overpaid sales tax on the transactions in the amount of $68.00, which is the difference between the taxes she did pay (based on the fictitious $649.99 and $349.99 prices), and the taxes she would have paid if not for Regulation 1585 (based on the true $199.99 and $99.99 prices)." Petitioner also alleges that she "is representative of millions of California consumers who have paid, and continue to pay, excessive sales taxes pursuant to the unlawful Regulation 1585."

Regulation 1585's purpose is to specifically address the application of the Sales and Use Tax Law to sales and purchases of wireless telecommunication devices. As explained above, and as applicable to the petition's alleged facts, Regulation 1585 defines the unbundled sales price of a wireless telecommunication device, such as an iPhone 5, as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." (Reg. 1585, subd. (a)(4).)

As discussed above, when available, the unbundled sales price is based on the actual price of the same wireless telecommunication device when sold in an unbundled transaction where the retailer does not receive consideration from a third party. Also, the unbundled sales price is only based on the "fair retail value" (generally the cost of the device plus an 18-percent markup) of a wireless telecommunications device in those cases where there are no unbundled sales of the device to use as an objective measure of tax, and the fair retail value is itself a reasonable estimate of the total consideration paid by both the consumer and the wireless telecommunications service provider to a retailer for the sale of a wireless telecommunications device in a bundled transaction, and no more. Therefore, Board staff has determined that Regulation 1585's provisions providing that sales and use tax applies to the unbundled sales price of wireless telecommunication devices sold in bundled transactions have a rational basis and are consistent with the definition of gross receipts in RTC section 6012, as interpreted by the courts and the Board. Accordingly, there is no evidence that the provisions are arbitrary, capricious, or clearly erroneous.

In addition, based upon the California Supreme Court's opinion in *Yamaha*, the Board's adoption of Regulation 1585 should be upheld because: (1) it is a quasi-legislative regulation; (2) its adoption was well within the Board's broad authority, under RTC section 7051, to adopt regulations for the administration and enforcement of the Sales and Use Tax Law; and (3) it was reasonably necessary for the Board to adopt Regulation 1585 to implement the provisions of RTC sections 6011 and 6012 as they relate to the unique and various types of bundled transactions involving sales of wireless telecommunication devices that started to appear in 1995.

Further, Regulation 1585 provides much needed certainty to all retailers of wireless telecommunication devices, including retailers required to collect use tax, regarding the gross receipts from or the sale price of wireless telecommunication devices sold in bundled transactions. Moreover, the repeal of Regulation 1585 would likely create much confusion for

retailers and may even create additional record keeping requirements for them. For example, if the specific provisions of Regulation 1585 were to be repealed with no additional rulemaking specifically prescribing the measure of tax with regard to sales of wireless telecommunication devices in bundled transactions, then, by default, the general provisions of Regulation 1671.1 may apply to sales of wireless telecommunication devices in bundled transactions. Thus, when a retailer enters into a contract with a manufacturer or third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products for a certain payment, such payments received by the retailer are part of the taxable gross receipts or sales price of the sales. Regulation 1671.1 would require such retailers to include in the measure of tax all the consideration they receive from wireless telecommunications service providers from such sales of wireless telecommunication devices at specified discounted prices and require such retailers to maintain records of such consideration.

In the event that retailers did not enter into such contracts as contemplated by Regulation 1671.1 with manufacturers or third parties, in the absence of any regulatory guidance, it appears that the statutes would require that all consideration received for the sale of the wireless telecommunication devices in a bundled transaction, whether from the customer or some other party, would be included in the measure subject to tax. This would include any payments promised to the retailer by a third party. Accordingly, without the "safe harbor" of Regulation 1585, this could result in a substantial increase in the measure subject to tax upon the sale of a wireless telecommunication device. Such a result could also require substantial recordkeeping by a retailer.

Furthermore, as discussed above, the Legislature has specifically considered whether to change the application of tax to sales of wireless telecommunications devices in bundled transactions on four separate occasions and has declined to do so. In other words, the Legislature has repeatedly acquiesced to the Board's duly promulgated interpretation of RTC sections 6011 and 6012, as applied to sales of wireless telecommunication devices in bundled transactions, set forth in Regulation 1585.

Here, the petition only generally alleges that Regulation 1585 conflicts with RTC section 6012. The petition does not quote any specific portion of RTC section 6012 with which the regulation purportedly conflicts. Rather, the petition merely makes the unsupported assertion that the Revenue and Taxation Code requires "that all sales taxes are to be calculated based on the 'gross receipts' retailers actually receive at the point of sale." As discussed above, this assertion is not an accurate interpretation of current law. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88; Reg. 1671.1.) Additionally, the petition does not provide any new information concerning the consideration that wireless telecommunication device retailers currently receive from wireless telecommunications service providers for selling devices at discounted prices in bundled transactions. Therefore, based upon the above analysis, the petition provides no basis that would warrant any changes to Regulation 1585.

III. Recommendation

Board staff recommends that the petition be denied in so far as it seeks the repeal of Regulation 1585 or portions thereof because the regulation is substantively valid and still necessary to prescribe the application of tax to sales of wireless telecommunication devices in bundled transactions.

If you need more information or have any questions, please contact Assistant Chief Counsel Robert Tucker at (916) 322-0437.

Approved:

Cynthia Bridges
Executive Director

Attachments: Petitioner's correspondence dated March 7, 2015
(which includes petition dated February 18, 2015, and other attachments)
Business Taxes Committee Formal Issue Paper No. 97-017

RF:RT:hp

cc: Ms. Cynthia Bridges MIC:73
Mr. Robert Tucker MIC:82
Mr. Bradley Heller MIC:82

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the March 26, 2015 Board Meeting

Joann Richmond, Chief
Board Proceedings Division

HATTIS LAW
2300 Geng Road, Suite 200
Palo Alto, CA 94303
Phone: 650.980.1990
www.hattislaw.com

March 7, 2015

VIA CERTIFIED MAIL RETURN RECEIPT REQUESTED

Randy Ferris, Chief Counsel
Office of the Chief Counsel
Legal Department MIC: 83
State Board of Equalization
450 N Street
Sacramento, CA 95814-0083

Re: Notice and Demand, on Behalf of My Client Jenny Lee and a Class of Similarly Situated California Consumers, that the Board, *inter alia*, Refund the Excess Sales Tax Collected Pursuant to Regulation 1585

Dear Mr. Ferris,

On February 26, 2015, I received a letter (attached hereto as Exhibit A) from Richard Bennion, Board Regulations Coordinator, acknowledging the Board's Legal Department had received my client Jenny Lee's Petition to repeal Regulation 1585. Mr. Bennion also confirmed in the letter, and in a phone call to me, that the Board accepted our emailed offer (attached hereto as Exhibit B) of a conditional open-ended extension of time for the Board to set a hearing on the Petition, conditioned on that extension being revocable by Ms. Lee on 30 days written notice to the CBOE. Mr. Bennion further stated in the letter that regardless of the extension, the Board anticipates scheduling a hearing on the Petition during the Board's March 25-26 meeting. (The Petition is attached hereto as Exhibit C.)

Ms. Lee's Petition that the Board repeal Regulation 1585 is only one part of the relief that she seeks on behalf of herself and a class of similarly situated California consumers (the "Class") who have paid excess sales tax pursuant to Regulation 1585 on wireless telecommunications devices purchased as part of a "bundled transaction" where they were required to enter into a wireless services contract.[1]

[1] The Class paid such excess sales tax in a manner similar to Ms. Lee, as further described in the Petition. *I.e.*, pursuant to Regulation 1585 - and in violation of the California Revenue and Taxation Code - Class members were charged sales tax on a fictitious and inflated "unbundled" sales price for their devices, rather than on the lower price they actual paid for the devices at the point of sale.

Ms. Lee also demands, on behalf of herself and the Class, that the Board do the following by March 26, 2015:

1. Ascertain that Regulation 1585 is unlawful and inconsistent with the California Revenue and Taxation Code;
2. Ascertain that the Class overpaid sales tax pursuant to Regulation 1585, in the amount of the difference between the sales tax they actually paid, and the lower sales tax that they would have paid if not for Regulation 1585;
3. Refund to the Class this excess sales tax collected by the Board pursuant to Regulation 1585; and
4. Direct retailers to refund to the Class any excess sales tax collected pursuant to Regulation 1585 which has not yet been submitted to the Board.

If the Board refuses to provide the demanded relief by March 26, 2015, Ms. Lee will file a class action lawsuit against the Board seeking declaratory relief, compensatory damages, restitution, and any other appropriate equitable relief.

Very truly yours,

Daniel M. Hattis

Enclosures
cc: Jenny Lee
Tony Tanke, Esq.
Bradley Heller, Tax Counsel IV, Board of Equalization
Richard Bennion, Regulations Coordinator, Board of Equalization

EXHIBIT A

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
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SEN. GEORGE RUNNER (RET.)
First District, Lancaster

FIONA MA, CPA
Second District, San Francisco

JEROME E. HORTON
Third District, Los Angeles County

DIANE L. HARKEY
Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

February 26, 2015

Subject: Petition to Repeal Sales and Use Tax Regulation 1585

Dear Mr. Hattis,

On Monday, February 23, 2015, the Legal Department received your petition filed on behalf of Ms. Jenny Lee, pursuant to Government Code section 11340.6, requesting the repeal of California Code of Regulations, title 18, section (Regulation) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices.*

We appreciate that Ms. Lee agreed to an open-ended extension of the 30-day period in Government Code section 11340.7 on the conditions that the extension is revocable by Ms. Lee on 30 days written notice to the Board and the Board is required to schedule a hearing on the petition within 30 days of Ms. Lee's notice of revocation, as indicated in your February 25, 2015, email.

Board staff anticipates scheduling a hearing on the petition during the Board's March 25-26, 2015, meeting in Sacramento. The public agenda notice (PAN) for that meeting will be available on the Board's website at www.boe.ca.gov at least 10 days prior to that meeting. The PAN will include a link to a Chief Counsel Memorandum setting forth the Legal Department's recommendation regarding the petition.

If you have any questions or need more information, please contact Bradley Heller, Tax Counsel IV, at 916-323-3091.

Sincerely,

Richard Bennion
Regulations Coordinator

EXHIBIT B

Subject: Petition to Repeal Regulation 1585

Date: Wednesday, February 25, 2015 at 12:26:52 PM Pacific Standard Time

From: Daniel Hattis

To: Richard.Bennion@boe.ca.gov

CC: Kirill Devyatov

Dear Mr. Bennion,

It was good speaking with you this morning regarding consumer Jenny Lee's petition to repeal Regulation 1585.

Petitioner is willing to grant a conditional open-ended extension of time for the CBOE to set a hearing on the Petition, conditioned on that extension being revocable by Petitioner on 30 days written notice to the CBOE. This would require the CBOE to set the hearing within 30 days of Petitioner's notice of revocation. It would also insure there would be no inordinate delays in proceedings on the Petition.

Please confirm that the CBOE will agree to this condition where the extension is revocable on 30 days notice. If the CBOE will not agree, then Petitioner will not grant an extension for the CBOE to deny or set a hearing on the Petition pursuant to Gov't Code Section 11340.7.

Thank you,

Dan Hattis
Hattis Law
Office: 650.980.1990
Mobile: 650.284.8495
www.hattislaw.com

Confidential: This email may contain information protected by the attorney-client or work-product privilege. If you have received this email in error, please notify me immediately and then delete the message and any attachments.

EXHIBIT C

BEFORE THE CALIFORNIA BOARD OF EQUALIZATION

In re Petition to the California Board of Equalization for Repeal of Cal. Code Regs. tit. 18, § 1585

PETITION TO THE CALIFORNIA BOARD OF EQUALIZATION FOR REPEAL OF CAL. CODE REGS. TIT. 18, § 1585

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Attorneys for Petitioner Consumer Jenny Lee

I. INTRODUCTION

Pursuant to Gov't Code § 11340.6, petitioner consumer Jenny Lee ("Petitioner") hereby petitions the California Board of Equalization ("CBOE") for the repeal of the Cal. Code Regs. tit. 18, §1585 ("Regulation 1585"). Petitioner purchased two mobile phones directly from AT&T, and was charged excessive sales tax on the phones at the point of sale. Pursuant to Regulation 1585, the sales tax was calculated not on the actual amount AT&T received for the transaction, but instead on a much higher fictitious "unbundled sales price," a term invented by the CBOE. The CBOE exceeded its authority in the promulgation of Regulation 1585 because the regulation is inconsistent with the California Revenue and Tax Code's requirement that all sales taxes are to be calculated based on the "gross receipts" retailers actually receive at the point of sale. *See* Rev. & Tax. Code §§ 6012 and 6051. The Regulation wrongly and unlawfully redefines "gross receipts" to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction. Regulation 1585 must be repealed because the Administrative Procedure Act forbids the enforcement of regulations that exceed the authority granted by, or that are in conflict with, their purportedly authorizing statute. *See* Gov't Code §§ 11342.1 and 11342.2.

II. INTEREST OF PETITIONER

Petitioner is an interested person because she paid excessive sales tax on mobile phones purchased from AT&T, where AT&T explicitly relied on Regulation 1585 in charging the tax. On December 27, 2012, Ms. Lee purchased an iPhone 5 for $199.99 from AT&T's retail store located at 3251 20th Ave., Suite 240, San Francisco, CA. On December 18, 2013, Ms. Lee purchased an LG Optimus G Pro mobile phone for $99.99 from the same store. *See* receipts at Exhibit A. Ms. Lee purchased each of the phones as part of a bundled transaction where she was required to sign a two-year contract with AT&T as her wireless carrier.

Pursuant to Regulation 1585, AT&T charged Ms. Lee sales tax of $55.25 on the iPhone, and $38.50 on the LG phone, based on what the CBOE calls the "unbundled sales price" of the phones. Ms. Lee would have paid sales tax of only $17.00 on the iPhone, and $8.75 on the LG phone, if the taxes had been based on the amount AT&T actually received, and she actually paid, at the point of sale. Ms. Lee overpaid sales tax on the transactions in the amount of $68.00, which is the difference between the taxes she did pay (based on the fictitious $649.99 and $439.99 prices), and the taxes she would have paid if not for Regulation 1585 (based on the true $199.99 and $99.99 prices).

On November 17, 2014, Ms. Lee filed a BOE-101 Claim for Refund with the CBOE requesting that the CBOE: (1) refund the $68.00 overpayment; (2) "ascertain" that Ms. Lee paid excessive sales tax; and (3) repeal Regulation 1585. *See* Exhibit B. On November 21, 2014, Ms. Lee received a written response from the CBOE denying her request. *See* Exhibit C. Ms. Lee is representative of millions of California consumers who have paid, and continue to pay, excessive sales taxes pursuant to the unlawful Regulation 1585.

III. ARGUMENT

Gov't Code § 11340.6 provides that any interested person may petition a California agency such as the CBOE to request the repeal of a regulation so long as the petition clearly and concisely states: "(a) The substance or nature of the regulation, amendment, or repeal requested, (b) The reason for the request, and (c) Reference to the authority of the state agency to take the action requested." Petitioner hereby petitions the CBOE to repeal Regulation 1585.

A. The substance or nature of the regulation, amendment, or repeal requested

The CBOE wrongly promulgated in Regulation 1585 that the "gross receipts" from mobile phone sales be measured by the "unbundled sales price" of the phone, even when the actual price charged and received by the retailer is significantly lower. Rev. & Tax. Code §§ 6012(a) defines

"gross receipts" as the total amount of money received by the retailer for the transaction. In Regulation 1585, the CBOE acknowledges that sales tax must be applied "to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction," but then unilaterally and unlawfully specifies that the bundled transaction be "measured by the unbundled sales price of that device." *See* Regulation 1585(b)(3).

Petitioner requests that the CBOE repeal Regulation 1585 because it is inconsistent with the plain meaning of the California Revenue and Taxation Code's requirement that sales tax be calculated based on the "gross receipts" retailers receive at the point of sale. In the alternative to the CBOE repealing Regulation 1585 in its entirety, Ms. Lee petitions the CBOE to repeal Sections (a)(3-4), (b)(3-6), and (c) of the Regulation.

B. The reason for the request

Ms. Lee is representative of millions of California consumers who have paid, and continue to pay, excessive sales taxes pursuant to the unlawful Regulation 1585. The CBOE denied Ms. Lee's BOE-101 Claim for Refund and told Ms. Lee that she has no standing to request a refund of sales tax from the CBOE, let alone to demand that the Regulation be repealed. *See* Exhibit B. This Gov't Code § 11340.6 Petition provides the only avenue remaining to Ms. Lee, short of a lawsuit, to demand a refund and the repeal of Regulation 1585.

Whatever its motives, an administrative agency such as the CBOE has no discretion to promulgate a regulation that is inconsistent with its governing statutes. *See Terhune v. Superior Court*, 65 Cal. App. 4th 864 (1998); *Pulaski v. California Occupational Safety & Health Standards Board*, 75 Cal. App. 4th 1315, 1341 (1999); *Transworld Sys., Inc. v. County of Sonoma*, 78 Cal. App. 4th 713, 717 (2000). The Administrative Procedure Act forbids the enforcement of regulations that exceed the authority granted by, or that are in conflict with, their purportedly authorizing statute. Regulations must "be within the scope of authority conferred in

accordance with the standards prescribed by other provisions of law." *See* Gov't Code § 11342.1. Regulations that "alter or amend the [governing] statutes or enlarge or restrict the agency's statutory power" are invalid. *California Beer & Wine Wholesalers Association v. Department of Alcoholic Beverage Control*, 201 Cal. App. 3d 100, 106-07 (1988).

The CBOE exceeded its authority when it promulgated Regulation 1585 because the regulation is inconsistent with the California Revenue and Taxation Code's requirement that all sales taxes are to be calculated based on the "gross receipts" retailers actually receive at the point of sale. *See* Rev. & Tax. Code §§ 6012 and 6051. Contrary to the clear language in the Tax Code, Regulation 1585 unlawfully redefines "gross receipts" -- and does so only with regard to mobile phones and other wireless telecommunication devices -- to include an imaginary, and arbitrary, dollar amount that is not actually received by the retailer for the transaction.

C. Authority of the CBOE to repeal Regulation 1585

The CBOE has authority to promulgate regulations relating to the administration and enforcement of the Tax Code pursuant to Rev. & Tax. Code § 7051. Consequently, the CBOE also has authority to repeal such regulations.

IV. DEMAND

Pursuant to Gov't Code §11340.7, the CBOE has thirty days from the receipt of this Petition to set a hearing on this Petition to repeal Regulation 1585 in its entirety (or in the alternative to repeal Sections (a)(3-4), (b)(3-6), and (c)), or to explain in writing why the CBOE denies the Petition. If the CBOE does not provide a response to this Petition, Ms. Lee will file a declaratory relief action pursuant to Gov't Code §11350 to challenge Regulation 1585 as inconsistent with the Tax Code.

//

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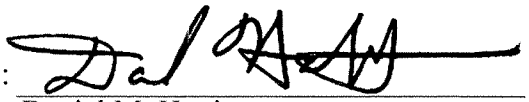
Petitioner looks forward to the CBOE's prompt response.

Dated: February 18, 2015

Respectfully submitted,

HATTIS LAW

By: 
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Attorneys for Petitioner Consumer Jenny Lee

EXHIBIT A to Petition

at&t

San Francisco Stonestown Retail Store
3251 20th Ave, Suite 240, AT&T Store
San Francisco, CA 94132
(415) 564-2171
Store No. S192 Register No. 41

Customer:
JENNY LEE
415-235-5851 (T)

69300 PHO IPHONE 5 16GB BLK 199.99
SER. NO. 013431001390824
Taxable Unit Value 649.99
ADDED 24 Months
CHANGED SIM: 89014103255422569328
CHANGED IMEI: 013431001390824
ADDED DATA PLAN UNL LTE TP
ACCOUNT NOTE 415-235-5851

Customer:
JENNY LEE
415-286-3200 (T)
DELETED IPHONE MSG UNL

Customer:
JENNY LEE
415-308-7721 (T)
ADDED Family Messaging UNL with

SUBTOTAL 199.99
TAX 55.25
TOTAL AMOUNT DUE 255.24
COMMITMENT SAVINGS - $450.00
CORPORATE ACCESSORY DISCOUNT $0.00
AMERICAN EXPRESS TENDERED 255.24
Acct No. XXXXXXXXXXX1007
Auth No. 509970

CHANGE DUE 0.00

YOUR TOTAL SAVINGS $450.00

American Express
Acct No. XXXXXXXXXXX1007
Auth No. 509970
AMOUNT $255.24
I HAVE RECEIVED GOODS AND
SERVICES IN THE ABOVE AMOUNT
SIGN X _____

CASHIER: STEPHANIE T

XSJ92ADVSL9
12/27/2012 13:08:27
STORE COPY

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

RETURN INFORMATION
Return & restocking fee policy on back

Pursuant to California Sales Tax Regulation 1585, tax on devices sold with services are calculated based on the no commit pricing.

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

at&t

San Francisco Stonestown Retail Store
3251 20th Ave, Suite 240, AT&T Store
San Francisco, CA 94132
(415) 564-2171
Store No. S192
CM Tablet No. 17

Customer:
JENNY LEE
415-308-7721 (T)

6053A	PHO LGE OPT G PRO E980	99.99
	SER. NO. 013520002278085	
	Taxable Unit Value 439.99	
40954	SIM UICC-G 3FF MICRO	0.00
	SER. NO. 89014104276557589740	
	Taxable Unit Value 0.00	
76304	DECLINED INSURANCE	0.00
	1 @ 0.00 No Discount Available	

ADDED 24 Months
CHANGED SIM: 89014104276557589740
CHANGED IMEI: 013520002278085
ADDED DataPro 3GB for Smartphone
ACCOUNT NOTE: 415-308-7721

SUBTOTAL	99.99
TAX	38.50
TOTAL AMOUNT DUE	138.49
COMMITMENT SAVINGS -	$340.00
CORPORATE ACCESSORY DISCOUNT	$0.00
VISA TENDERED	138.49

Acct No. XXXXXXXXXXXX5056
Auth No. 052158

CHANGE DUE 0.00

YOUR TOTAL SAVINGS $340.00

Visa
Acct No. XXXXXXXXXXXX5056
Auth No. 052158
AMOUNT $138.49
I HAVE RECEIVED GOODS AND
SERVICES IN THE ABOVE AMOUNT

CASHIER: VINCENT W

X 3 1 5 2 1 1 6 5 8 3 F 9

10/08/2013 18:58:46
STORE COPY

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

RETURN INFORMATION
Return & restocking fee policy on back.
Pursuant to California Sales Tax
Regulation 1585, tax on devices sold with
service are calculated based on the no
commit pricing.

****
THANK YOU FOR CHOOSING AT&T!
****

NEED HELP?
Get 24 x 7 support for all your
AT&T services at att.com/support

EXHIBIT B to Petition

HATTIS LAW

Daniel M. Hattis, Esq.
2300 Geng Road, Suite 200
Palo Alto, CA 94303
dan@hattislaw.com
T – 650.980.1990
F – 650.989.4189

November 17, 2014

State Board of Equalization
P.O. Box 942879
Sacramento, CA 94279

Re: My Client: Jenny Lee
BOE-101 Claim for Refund
Overpayment of Sales Tax on Mobile Phone

To Whom It May Concern:

Please find enclosed my above-referenced client's claim for a refund of $68.00 for overpaid sales tax on mobile phones purchased on December 27, 2012 and December 18, 2013.

Very truly yours,

Daniel M. Hattis

Enclosures: BOE-101, Exhibit A, Copy of Sales Receipts

BOE-101 (FRONT) REV. 7 (11-09)

CLAIM FOR REFUND OR CREDIT

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

(Instructions on back)

NAME OF TAXPAYER(S) OR FEEPAYER(S)
Jenny Lee

TAXPAYER'S OR FEEPAYER'S ACCOUNT NO.

GENERAL PARTNER *(if applicable)*

TAXPAYER'S OR FEEPAYER'S SOCIAL SECURITY NUMBER(S)* OR FEDERAL EMPLOYER IDENTIFICATION NUMBER
[redacted]

According to

- ☑ Chapter 7, Article 1, of the California Sales and Use Tax Law, and where applicable, Uniform Local Sales and Use Tax Ordinances and the Transit District Transactions (Sales) and Use Tax Ordinances, or
- ☐ Chapter 6, Article 1, of the California Use Fuel Tax Law, or
- ☐ Chapter 8, Article 1 and 2, of the Diesel Fuel Tax Law,
- ☐ Other _____ *(please specify the applicable tax law or fee program)*

the undersigned hereby makes claim for refund or credit of $ 68.00 *(may be left blank)*, or such other amounts as may be established, in tax, interest and penalty in connection with:

☐ Return(s) filed for the period _____ to _____

☐ Determination(s) dated _____ and paid _____

☑ Other *(describe fully)*

Ms. Lee's overpayment of mobile phone sales taxes paid on 12/27/12 and 12/18/13, because CBOE Regulation 1585, upon which the AT&T relied in charging her sales tax on inflated and fictitious transaction amounts, is unlawful.

The overpayment described above was caused by

See attached "Exhibit A"

Supporting Documentation:

☑ is attached
☐ will be provided upon request

BUSINESS NAME

SIGNED BY

DATE SIGNED
11/17/2014

PRINT NAME OF SIGNATORY
Daniel M. Hattis

CONTACT PERSON *(if other than signatory)*

TITLE OR POSITION
Attorney for Ms. Lee

TELEPHONE NUMBER
(650) 980-1990

TITLE OR POSITION OF CONTACT PERSON

TELEPHONE NUMBER
( )

☐ *Credit interest is available under certain circumstances. If you would like to be considered for credit interest, please check here.*

*See BOE-324-GEN, Privacy Notice, regarding disclosure of the applicable social security number.

FOR BOE USE ONLY

Case ID No. _____

EXHIBIT A
Form BOE-101
Jenny Lee, SSN [redacted]

On December 27, 2012, Ms. Lee purchased an iPhone 5 mobile phone from AT&T's retail store located at 3251 20th Ave., Suite 240, San Francisco, CA, for $199.99. On December 18, 2013, Ms. Lee purchased an LG Optimus G Pro mobile phone from the same store for $99.99. *See* attached receipts. Ms. Lee purchased each of the mobile phones as part of a bundled transaction where she was required to sign a two-year contract with AT&T as her wireless carrier.

Pursuant to California Board of Equalization ("CBOE") Regulation 1585, AT&T charged Ms. Lee sales tax of $55.25 on the iPhone 5, and $38.50 on the LG phone, based on what the CBOE calls the "unbundled sales price" of the phones. Ms. Lee would have paid sales tax of only $17.00 on the iPhone 5, and $8.75 on the LG phone, if the taxes had been based on the amount AT&T actually received, and she actually paid, at the point of sale. Ms. Lee believes she overpaid sales tax on the transactions and demands a refund in the amount of $68.00, which is the difference between the taxes she actually paid (based on the fictitious $649.99 and $439.99 prices), and the taxes she should have paid (based on the true $199.99 and $99.99 prices she was actually charged for the phones).

Ms. Lee is entitled to the refund because Regulation 1585, which AT&T explicitly relied upon in charging the excess tax, is unlawful. Regulation 1585 directly conflicts with the California Revenue and Tax Code's ("Tax Code") explicit requirement that sales taxes be limited to the "gross receipts" retailers receive at the point of sale. *See* Rev. & Tax. Code § 6051. The Tax Code defines gross receipts as the total amount of money received by the retailer for the transaction. *Id.* § 6012. Under Regulation 1585, the CBOE wrongly redefined "gross receipts" with regard to mobile phone sales to be measured by the "unbundled sales price" of the phone (*e.g.*, $649.99), even when the actual price paid to the retailer is significantly lower (*e.g.*, $199.99). Under Regulation 1585 retailers are directed to pay (and are permitted to pass through to consumers) taxes on entirely imaginary transaction amounts never actually paid to the retailers, in direct violation of Rev. & Tax. Code §§ 6051 and 6012.

CBOE exceeded its authority in creating Regulation 1585. The CBOE may only "prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement" of the Tax Code. *Id.* § 7051. The CBOE cannot invent new taxes out of whole cloth that directly conflict with the clear language of the Tax Code itself.

Based on the foregoing, Ms. Lee demands a refund from the CBOE in the amount of $68.00, which is the excess sales tax she paid, and the CBOE received, under the unlawful Regulation 1585 sales tax scheme. Ms. Lee demands that pursuant to Rev. & Tax. Code § 6901.5, the CBOE "ascertain" that she paid sales taxes computed on amounts (*i.e.*, $649.99 and $439.99) that were in excess of the taxable amounts (*i.e.*, $199.99 and $99.99). She further demands that the CBOE repeal Regulation 1585.

EXHIBIT C to Petition

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0039
TELEPHONE (916) 324-3017
FAX (916) 445-2249 OR 324-0147
Roslyn.Nera@boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Orange County

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

November 20, 2014

Daniel M. Hattis, Esq.
2300 Geng Rd., Suite 200
Palo Alto, CA 94303

Re: Jenny Lee
Request for Refund
Postmarked: November 17, 2014
Received: November 19, 2014

Dear Claimant:

Your claim for refund postmark dated November 17, 2014 and received in our office on November 19, 2014; in which you request a refund of $68.00 for sales tax paid to AT&T has been referred to this office for consideration.

Under California law, a refund of an overpayment of sales tax may be made only to the firm or individual who paid the tax to this Board. Your recourse, therefore, is to contact AT&T. They, in turn, may file a claim for refund with us, supported by the proper documentation. Any refund due would be issued to the seller with the provision that it passed on to you.

We regret that we cannot be of direct assistance to you in this matter.

Thank you for your cooperation.

Sincerely,

Roslyn D. Nera
Senior Tax Auditor
Audit Determination & Refund Section

FORMAL ISSUE PAPER
(Rev. 10-97)

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Issue Paper Number 97-017

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

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

97-017
Regulation 1585 - Cellular Telephones, Pagers, and Other Telecommunications Devices

I. Issue

Should the Board authorize publication of proposed Sales and Use Tax Regulation 1585, *Cellular Telephones, Pagers, and Other Telecommunications Devices*?

II. Staff Recommendation

Staff recommends the Board authorize publication of the attached proposed new Regulation 1585, with minor revisions as suggested by industry and noted within section (V), subdivision (A).

III. Other Alternative(s) Considered

Not applicable.

IV. Background

The wireless telecommunications industry is a rapidly changing industry, existing in a fluctuating and capricious market place. Consequently, marketing and retail pricing strategies that contradict conventional and customary retail practices are rampant within this industry, resulting in widespread, below cost sales of cellular telephones and paging devices. The practice is facilitated by the direct payment of rebates and/or commissions, by the wireless telecommunications service provider, to the retailers who couple the respective contract for utility service with the sales of the wireless telecommunications devices.

When a retailer of cellular telephones requires that the purchaser obtain wireless telecommunications service (bundles) from a particular service provider who will then pay the retailer a commission, the Board regards the commissions as part of the taxable gross receipts from the retailer's sale of the telecommunications device. Since the purchaser presumably has a contract with and pays the service provider for the wireless telecommunications service, the payment from the customer to the service provider is not included in the measure of tax. However, the rebates and/or commissions received by the retailer from the service provider are not for exempt wireless telecommunications service. Consequently, the indirect reimbursement for the wireless telecommunications devices in addition to the amount specifically charged the customer on the sales agreement is required to be included in the measure of tax.

Under Revenue and Taxation Code section 6012, gross receipts received from the retail sale of tangible personal property in this state are subject to tax. Taxable gross receipts include the total sales price, valued in money, whether received in money or otherwise, with no deduction for charges, expenses, or services that are part of the sale. Normally, a service is regarded as part of the sale if the purchaser cannot obtain the tangible personal property without also obtaining the service, or cannot obtain the tangible personal property at the same price without the service.

Although below cost pricing was occurring in the industry as early as 1991, retailers did not bring the issue before staff until sometime in 1993. Apparently, the affected retailers believed the issue was handled through legislation introduced in 1992. In an effort by the Legislature to deal with below cost pricing, Assembly Bill 275 (Stats 1992, Ch. 542) was introduced and subsequently added section 17026.1 to the California Business and Professions Code (B&P). The bill specifically addressed the issue of offering discounts to customers who activated service, and the respective commissions that were paid to the retailers upon such activation. In doing so, it appeared that the Legislature provided the necessary provisions to prevent extensive below cost pricing in the industry.

Operative January 1, 1994, section 17026.1 of the B&P Code provides that:

> (b) In each retail location, all retailers of cellular telephones shall post a large conspicuous sign...that states the following: "Activation of any cellular telephone is not required and the advertised price of any cellular phone is not

contingent upon activation, acceptance, or denial of cellular service by any cellular provider."

Section 17026.1(a)(2) of the Business and Professions Codes states that:

"...providers of cellular service shall be permitted to sell cellular telephones below cost, provided that sales below cost are a good faith endeavor to meet the legal market prices of competitors in the same locality or trade area."

Further, section 17026.1(a)(1) provides that:

"...commissions or rebates regularly earned by the retailers of cellular telephones may be used to reduce cost, provided, that in no event shall the reduction exceed the greater of the following: (A) Ten percent of cost, ...or (B) Twenty dollars ($20)."

Thus, a cellular telephone retailer was not expected to place a specific written stipulation on a customer with respect to coupling an activation policy as a prerequisite for the purchase of cellular equipment. Nevertheless, in the last four to five years staff has been responding to numerous complaints and concerns of a number of retailers who have been negatively impacted by the competitive selling practice of pricing wireless telecommunications devices significantly below cost. In 1993, such pricing was as much as 40 to 50% below cost. Retailers expressing their concerns believed that the Board should administer fair trade provisions with respect to the pricing of wireless telecommunications devices, since many retailers appeared to be ignoring the provisions found within the B&P Code.

New marketing and pricing strategies continued to be introduced and practiced within the industry. Staff continued to receive inquiries from retailers concerned with the industry's frequent below cost pricing practices, and what many continued to refer to as "unfair" competition. Throughout 1994 and into 1995, staff continued to track the situation, and maintained its contact with industry representatives. Until the beginning of 1995, extensive below cost pricing appeared to be confined to a limited number of retailers within the industry.

However, in April of 1995, things changed within the wireless telecommunications industry. On April 5, 1995, the California Public Utilities Commission (PUC) approved tying cellular telephone sales with specific wireless telecommunications service and, in doing so, reversed their long standing ban against "bundling" (the practice of coupling wireless device sales with the respective utility service contract) in the industry. This caused confusion on the part of many retailers, resulting in telephone calls to staff and rumors that the PUC would reverse their decision. Apparently, retailers believed the PUC decision was in direct conflict with B&P Code section 17026.1(c) that provides that:

"No retailer of cellular telephones shall refuse to sell a cellular telephone to any customer solely on the basis of the customer's refusal to activate the telephone with the provider of cellular service for whom the retailer is an agent.... The

> intent of this subdivision is to reaffirm the Legislature's support for the Public Utilities Commission's policy that makes illegal the act, or practice of "bundling," as defined and described in relevant decisions and orders of the commission."

Since the PUC decision did not result in a like reversal of B&P Code section 17026.1(c), retailers believed that the Board could enforce the B&P Code and, as such, assist in invalidating the PUC decision. However, even though the respective B&P Code provisions directly related to the "bundling" issue, the statutes continue to be beyond the administrative province of the Board. Additionally, subdivision (d) of the B&P Code provides what can be deemed a disclaimer against any provisions of the B&P Code that may conflict with the rules, regulations, or orders promulgated or issued by the PUC. Consequently, the PUC stance on "bundling" opened the door for new and inventive marketing strategies within the wireless telecommunications industry, resulting in extensive below cost pricing, with such "steep" discounts being contingent on the customers' activation with a related service provider.

With the "steep" discounts and required activation (bundling), and the fact that the B&P Code did not invalidate the PUC decision, came confusion over what portions of the retailers' receipts were included in taxable measure. Since retailers are generally able to recoup such discounts through the commissions and/or rebates paid by the service providers, and such activation is a condition of the sale, staff regards the commissions as part of the gross receipts received for the retailers' sale of the wireless device. Accordingly, this presented an additional dilemma for the retailers, industry, and staff.

On April 24, 1997, staff met with retailers and cellular officials to discuss the application of tax to bundled transactions. During the meeting, the retailers expressed concern with the administrative difficulty of tracking and properly reporting the commission component of gross receipts received on wireless device transactions. For administrative ease, the retailers advocated reporting tax measured by the price at which the device is sold to customers who do not contract for the wireless telecommunications service. Such price is commonly referred to as the "unbundled" or "unactivated" price. The service providers also agreed to this pricing structure as they did not want two standards giving them a competitive advantage over the retailers. Staff agreed to examine documents related to these types of cellular transactions and determine the feasibility of the industry proposal. Considering the results of staff's analysis, staff recommended that retailers be allowed to report tax measured by the unbundled retail selling price. Due to the unique nature of this reporting basis, staff has continued to work with and maintain contact with industry representatives to ensure clarification concerning this matter and to enlist their assistance in drafting the proposed regulation.

To summarize, present day sales of wireless telecommunications devices at prices as low as 90% below cost are occurring throughout the wireless telecommunications industry. In many instances, the devices are offered free of charge. Whatever the pricing strategy, the "steep" discounts are almost always contingent upon activation with a specific wireless telecommunications service provider. In contrast to past practices, small and

large retailers alike are practicing today's below cost pricing of analog cellular telephones and various types of pagers.

Considering the transitory nature of the industry's marketing and pricing strategies and the tendency for the various wireless devices to become outdated and replaced with "smaller and better" models within a short period of time, the regulation must provide specific statutory interpretations that conform to not only the governing provisions of section 6012, but other statutory laws within the Revenue and Taxation Code as well. Additionally, the draft must be flexible enough to provide for the application of tax to the sales of devices occurring in today's market and those that took place in the past, as well as those expected to occur in the future. Although the marketing strategies of the industry are somewhat unique to that specific industry, the premise upon which the regulation's statutory authority is based is not unique. It is the principle upon which the taxability of all retail sales is firmly established.

Consequently, staff is endeavoring to provide guidance to the industry, while attempting to effectively administer and implement the applicable provisions of the law. To do so, staff has written proposed regulation 1585 with the input and assistance of industry representatives. Accordingly, staff has had many telephone conversations with industry representatives and received feedback and suggestions concerning the drafting of the regulation.

Proposed Regulation 1585 was designed primarily to address the application of tax in two situations: 1) the sale of a cellular telephone or pager in a bundled transaction; and 2) the sale of a cellular telephone or pager requiring activation exclusively with a particular utility service provider. Although industry's input has been invaluable, staff disagrees with some of industry's proposals (attachment 2) to the extent they depart from either of these objectives. Staff's thoughts on industry's proposed changes to the proposed draft of Regulation 1585 are provided within the text of the recommendation portion of this paper.

V. Staff Recommendation

A. Recommendation.

Staff recommends the following specific provisions of proposed new regulation 1585. Recommendations discuss industry's input and, when appropriate, recommend inclusion of same.

- Subdivision (a). Subdivision (a) provides the following definitions to provide the understanding and clarity necessary to interpret, implement, and make certain Section 6012.

1. Subdivision (a)(1) defines the term wireless telecommunications device, the sales of which the provisions of the proposed regulation relate. "Wireless telecommunications device" is meant to include portable wireless communication devices such as cellular telephones and pagers requiring activation by a utility service provider in order to function. Industry proposes to change the term of "utility service provider" to "wireless telecommunications service provider." Staff agrees with the proposed change.

2. Subdivision (a)(2) defines the term "utility service provider" to mean a utility regulated by the Public Utilities Commission or the Common Carrier Bureau of the Federal Communications Commission, which offers and/or provides wireless utility service. Industry proposes to define a wireless telecommunications service provider as "a provider of commercial mobile radio services as defined in ...47 CFR 20.3." Staff cannot agree with this proposal for the following reasons: 1) Proposed Regulation 1585 would be subject to definitional changes that may occur by way of modification to the CFR. For example, if 47 CFR 20.3 was modified by Congress or the FCC, proposed Regulation 1585 would also be changed; and 2) 47 CFR 20.3 does not appear to cover all aspects of wireless telecommunications as contemplated by proposed Regulation 1585.

3. Subdivision (a)(3) defines the term "bundled transaction" as the retail sale of a wireless telecommunications device requiring the retailer's customer to contract with a utility service provider as a condition of that sale. The subdivision interprets, implements, and makes certain Section 6012. Industry proposes to add "activate or" to subdivision (a)(3). With the suggested additional wording, subdivision (a)(3) to read as follows: "The retail sale of a wireless telecommunications device requires the retailer's customer to activate or contract with a wireless telecommunications utility service provider for utility service as a condition of that sale."... Staff accepts the proposed additional language.

4. Subdivision (a)(4) interprets, implements and makes certain section 6012. Industry proposes elimination of language making the unbundled sales price equal to the fair retail selling price consistent with industry's usual and customary retail pricing practices. Staff believes this language should be left in, but that it could be modified to reflect the pricing practices of local retailers. Staff and industry do agree that the regulation should address the sale of discontinued and obsolete merchandise. Staff believes that industry's "lined-out" language should be replaced with: "the unbundled sales price of a wireless telecommunications device shall equal the fair retail selling price of that device and shall be consistent with the usual and customary retail pricing practices of other local retailers for the type of device sold. The unbundled sales price of an obsolete wireless telecommunications device shall equal the

actual selling price of that device." Staff also recommends that the words "would sell" on line one be changed to "has sold."

5. Subdivision (a)(5) interprets section 6012 as it pertains to exclusive wireless service provider transactions. Industry proposes that the name for these types of transactions be changed to "Consignment Transactions" and that language defining these transactions be copied from a portion of industry's proposed revisions to subdivision (b)(3). Staff disagrees. These types of transactions are not always consignment sales in that the person transferring the device to the end-use customer often has title to the device. Industry's proposed definition also fails to recognize that the end-use customer is required to contract exclusively with a particular service provider as a condition of purchasing the wireless device. Staff does believe that the term "Carrier Restricted Transaction" should be replaced with the term "Exclusive Service Provider Transactions" for clarification purposes.

6. Subdivision (a)(6) defines retail utilities transactions as the combined retail sale of a wireless telecommunications device and the respective service by a single retailer. Industry proposes a different name for the definition of this type of transaction. Staff remains of the opinion that the word "utilities" is necessary for describing these types of transactions.

- Subdivision (b). Interprets and makes certain the application of tax to these types of transactions.

1. Subdivision (b)(1) interprets and makes certain section 6012.

2. Subdivision (b)(2) interprets and makes certain section 6012. See subdivision (a)(6) for staff's response to industry's proposals concerning this subdivision.

3. Subdivision (b)(3) interprets, implements, and makes certain section 6012. As for industry's proposed changes, industry continues to classify all transactions as consignment sales and proposes that two separate entities pay tax measured by a portion of the total amount collected from an end-use customer. (This would also mean that two separate entities would attempt to collect tax reimbursement from a single, end-use customer.) Staff disagrees with this proposal. As set forth in staff's response to subdivision (a)(5), not all transactions within this category are consignment sales. Staff further believes that allowing two different entities to report tax on a portion of the total amount collected from an end-use customer would create consumer protection problems as well as administrative difficulties in performing audits. One alternative is to allow the person deemed the retailer for the transaction to report tax measured by the entire unbundled sales price of the wireless telecommunications device.

4. Subdivision (b)(4) interprets, implements, and makes certain section 6012. Staff believes that industry no longer objects to the provisions of this subdivision. However, one other interested party has suggested that language be added to clarify the meaning of electronic modification. Although staff does not object to inclusion of such clarification, it may not be considered necessary. Industry and staff are in agreement regarding the difference between the electronic modification of a telecommunications device and the act of electronically activating such a device.

- Subdivisions (c) and (c)(1) implement and make certain the provisions of Regulation 1642.

  1. Subdivision (c)(2) implements and makes certain the provisions of Regulation 1642 as they apply to charge-backs by the wireless telecommunications service provider to the retailer. Industry proposes that the words "a payment or rebate" be substituted with the word "consideration." Staff disagrees with this proposal. The word consideration is a technical legal term, with a particular meaning and consequences. The regulation uses terms commonly understood in the business community, in accordance with rulemaking requirements.

  2. Subdivision (c)(3) implements and makes certain the provisions of Regulation 1642 as they apply to charge-backs concerning retail utility transactions.

B. Pros.

This proposed new regulation is necessary to provide guidance and clarification to that part of the public affected by it.

C. Cons.

There appear to be no negative aspects of the recommendation.

D. Statutory or Regulatory Change.

As recommended, it is suggested that proposed Regulation 1585 be published and adopted.

E. Administrative Impact.

The adoption and publication of proposed Regulation 1585 will provide staff with the regulatory authority to continue to implement current policies and procedures.

F. Fiscal Impact.

1. Cost Impact.

   Staff is currently implementing provisions. Any associated costs are absorbable.

2. Revenue Impact.

   Since the provisions of the regulation reflect current policy, a revenue impact is not expected.

G. Taxpayer/Customer Impact.

Taxpayers will be better informed on the proper application of tax and, as such, better able to accurately report the tax due.

H. Critical Time Frame.

As the transactions addressed within the proposed regulation are already occurring, guidance needs to be provided as soon as possible.

VI. Alternative 1

Not applicable.

Prepared by: Sales and Use Tax Department, Audit Evaluation, Planning, and Settlement Section.

Current as of December 17, 1997.

Regulation 1585. CELLULAR TELEPHONES, PAGERS, AND OTHER WIRELESS TELECOMMUNICATION DEVICES.

(a) DEFINITIONS.

(1) WIRELESS TELECOMMUNICATION DEVICE. A portable communication device such as a cellular telephone or pager requiring activation by a utility service provider or seller of utility services in order to send, receive, or send and receive transmissions via a network of wireless transmitters throughout multiple service areas, or otherwise.

(2) UTILITY SERVICE PROVIDER. A utility regulated by the Public Utilities Commission or the Common Carrier Bureau of the Federal Communications Commission which offers or provides wireless communication or paging services.

(3) BUNDLED TRANSACTION. The retail sale of a wireless telecommunication device which requires the retailer's customer to contract with a utility service provider for utility service as a condition of that sale. A transaction is a bundled transaction within the meaning of this section without regard to the method in which the price is stated to the customer. Also, it is immaterial whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice.

(4) UNBUNDLED SALES PRICE. The price at which a retailer would sell a specific wireless telecommunication device to a customer who is not required to activate or contract with a utility service provider for utility service as a condition of that sale. The unbundled sales price of a wireless telecommunication device shall equal the fair retail selling price of that device and shall be consistent with the industry's usual and customary retail pricing practices for the type of device sold.

(5) CARRIER RESTRICTED TRANSACTION. The sale of a wireless telecommunication device which requires the customer purchasing the device to contract with one specific utility service provider for utility service as a condition of that sale. The customer purchasing the wireless telecommunication device is generally required to pay a predetermined fee to the utility service provider in the event that customer fails to obtain utility service from that utility service provider. The person providing the wireless telecommunication device to the customer does not receive a rebate or payment for obtaining the customer's contract with that utility service provider.

(6) RETAIL UTILITIES TRANSACTION. The combined retail sale of a wireless telecommunication device and utility service by a single retailer not affiliated with, or a part of, a utility service provider. The retailer of a wireless telecommunication device purchases utility service from a utility service provider for sale directly to its customer. Customers are required to contract for utility service from the retailer upon the sale of a wireless telecommunication device to that customer. The sales price listed on the customer's sales receipt or invoice for the wireless telecommunication device may or may not be below the retailer's acquisition cost of that device. The customer continues to pay the retailer for utility service throughout the duration of the utility service contract.

(b) APPLICATION OF TAX.

(1) IN GENERAL. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device. The retailer of the wireless telecommunication device is required to report and pay the tax.

(2) BUNDLED TRANSACTIONS AND RETAIL UTILITIES TRANSACTIONS. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction or in a retail utilities transaction, measured by the unbundled sales price of that device. Tax applies to the unbundled sales price whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice. The retailer of the wireless telecommunication device is required to report and pay tax measured by the unbundled sales price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. Tax does not apply to the charges in excess of the unbundled sales price made for telecommunication services.

(3) CARRIER RESTRICTED TRANSACTIONS. The utility service provider is generally regarded as the retailer of the wireless telecommunication device notwithstanding any agreement or contractual obligation between the utility service provider and the person or entity providing the device to an end-use customer. Where the utility service provider reimburses or rebates money to a separate person or entity, that person or entity receiving the reimbursement or rebate is regarded as the retailer of the wireless telecommunication device. In either event, the person or entity regarded as the retailer of the wireless telecommunication device owes tax to the Board measured by the unbundled sales price of that device. The retailer may not collect tax or tax reimbursement from either the end-use customer or the person selling the device to the end-use customer.

(4) ACTIVATION FEES. Tax does not apply to a one-time charge for activating a new wireless telecommunication device with, or on behalf of, a utility service provider where the charge is separately stated and is not for the electronic or physical modification of the device in order for it to function within a utility service provider's service network. A one-time charge for activating a wireless telecommunication device is subject to tax if the activation consists of the physical or electronic modification or fabrication of a wireless telecommunication device in order for the device to function within a utility service provider's service network. The person collecting this fee is required to report and pay tax on that amount. Any subsequent charge for the physical or electronic modification or fabrication of that device which changes the customer's telephone number or which allows that customer to utilize a different utility service provider is subject to tax as set forth in Regulation 1546 (18 CCR 1546).

(c) BAD DEBT DEDUCTIONS.

(1) IN GENERAL. The provisions of Regulation 1642, "Bad Debts" (18 CCR 1642), apply to retailers making sales of wireless telecommunication devices pursuant to subdivision (b)(1).

(2) CHARGE-BACKS TO THE RETAILER. Retailers reporting tax measured by the unbundled sales price of a wireless telecommunication device may take a bad debt deduction pursuant to Regulation 1642 when a payment or rebate from a utility service provider is charged-back to the retailer based on a customer's termination of its contract with the utility service provider before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by the retailer from the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the debt owed by the customer and the corresponding credit for excess tax reimbursement.

(3) RETAIL UTILITY TRANSACTIONS. Retailers of wireless telecommunication devices sold in a retail utilities transaction may take a bad debt deduction pursuant to Regulation 1642 when a customer terminates its utility service contract with the retailer before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by the retailer in connection with the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. The amount collected from the customer on the retail utility transaction shall be allocated among the total amount collected for both the wireless telecommunication device and utility service by dividing the unbundled sales price by the total amount the retailer would have collected if the customer fully performed under the terms of the utility service contract, and then multiplying that amount by the total amount collected by the retailer to date.

Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the bad debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the debt owed by the customer and the corresponding credit for excess tax reimbursement.

NOTE: Authority cited: Section 7051, Revenue and Taxation Code.
Reference: Sections 6006, 6010, 6011, 6012, and 6055, Revenue and Taxation Code.

Regulation 1585. CELLULAR TELEPHONES, PAGERS, AND OTHER WIRELESS TELECOMMUNICATIONS DEVICES

(a) DEFINITIONS.

(1) WIRELESS TELECOMMUNICATIONS DEVICE. A portable communications device such as a cellular telephone or pager requiring activation by a **wireless telecommunications** ~~utility~~ service provider or seller of utility services in order to send, receive, or send and receive transmissions via a network of wireless transmitters throughout multiple service areas, or otherwise.

(2) WIRELESS TELECOMMUNICATIONS ~~UTILITY~~ SERVICE PROVIDER. **A provider of commercial mobile radio services as defined in the Code of Federal Regulations under 47 CFR 20.3.** ~~A utility regulated by the Public Utilities Commission or the Common Carrier Bureau of the Federal Communications Commission which offers or provides wireless communication or paging services.~~

(3) BUNDLED TRANSACTION. The retail sale of a wireless telecommunications device which requires the retailer's customer to **activate or** contract with a **wireless telecommunications** ~~utility~~ service provider for utility service as a condition of that sale. A transaction is a bundled transaction within the meaning of this section without regard to the method in which the price is stated to the customer. Also, it is immaterial whether the wireless telecommunications device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice.

(4) UNBUNDLED SALES PRICE. The price at which the a retailer would sell a specific wireless telecommunications device to a customer who is not required **to activate or** contract with a **wireless telecommunications** ~~utility~~ service provider for utility service as a condition of that sale. ~~The unbundled sales price of a wireless telecommunications device shall equal the fair retail selling price of that device and shall be consistent with the industry's usual an customary retail pricing practices for the type of device sold.~~

~~(5) CARRIER RESTRICTED TRANSACTION. The sale of a wireless telecommunications device which requires the customer purchasing the device to contract with one specific wireless telecommunications utility service provider for utility service as a condition of that sale. The customer purchasing the wireless telecommunications device is generally required to pay a predetermined fee to the wireless telecommunications utility service provider in the event that customer fails to obtain utility service from that wireless telecommunications utility service provider. The person providing the wireless telecommunications device to the customer does not receive a rebate or payment for obtaining the customer's contract with that wireless telecommunications utility service provider.~~

(6) RETAIL ~~UTILITIES~~ TRANSACTION. The combined retail sale of a wireless telecommunications device and utility service by a single retailer not affiliated with, or part of, a **wireless telecommunications** ~~utility~~ service provider. The retailer of a wireless telecommunications device purchases utility service from a **wireless telecommunications** ~~utility~~ service provider for sale directly to its customer. Customers are required to contract for utility service from the retailer upon the sale of a wireless telecommunications device to that customer. The sales price listed on the customer's sales receipt or invoice for the wireless telecommunications device may or may not be below the retailer's acquisition cost of that device. The customer continues to pay the retailer for utility service throughout the duration of the utility service contract.

(b) APPLICATION OF TAX.

(1) IN GENERAL. Tax applies to the gross receipts from the retail sale of a wireless telecommunications device. The retailer of the wireless telecommunications device is required to report and pay the tax.

(2) BUNDLED TRANSACTIONS AND RETAIL ~~UTILITIES~~ TRANSACTIONS. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction or in a retail ~~utilities~~ transaction, measured by the unbundled sales price of that device. Tax applies to the unbundled sales price whether the wireless telecommunications device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice. The retailer of the wireless telecommunications device is required to report and pay tax measured by the unbundled sales price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. Tax does not apply to the charges in excess of the unbundled sales price made for telecommunications services.

(3) CONSIGNMENT ~~CARRIER RESTRICTED~~ TRANSACTIONS. **Where** the wireless **telecommunications** ~~utility~~ service provider **retains title to the wireless communications device and consigns the wireless communications device to a third party for sale or lease to customers, that wireless telecommunications service provider** is generally regarded as the retailer of the wireless telecommunications device notwithstanding any agreement of contractual obligation between the **wireless telecommunications** ~~utility~~ service provider and the person or entity providing the device to an end-use customer. Where the **wireless telecommunications** ~~utility~~ service provider **provides consideration** ~~reimburses or rebates money~~ to a separate person or entity, that person or entity receiving the **consideration** ~~reimbursement or rebate~~ is regarded as the retailer of the wireless telecommunication device. In either event, the person or entity regarded as the retailer of the wireless telecommunications device owes tax to the Board measured by the unbundled sales price of that device. **If the retailer is the wireless telecommunications service provider, the wireless telecommunications service provider may reduce (or take a credit for) the amount of California sales tax due using the unbundled price approach by the amount of sales tax paid by the consumer on the retail transaction.** ~~The retailer may not collect tax or tax reimbursement from either the end-use customer or the person selling the device to the end-use customer.~~

~~(4) ACTIVATION FEES. Tax does not apply to a one time charge for activating a new wireless telecommunication device with, or on behalf of, a utility service provider where the charge is separately stated and is not for the electronic or physical modification of the device in order for it to function within a utility service provider's service network. A one time charge for activating a wireless telecommunication device is subject to tax if the activation consists of the physical or electronic modification or fabrication of a wireless telecommunication device in order for the device to function within a utility service provider's service network. The person collecting this fee is required to report and pay tax on that amount. Any subsequent charge for the physical or electronic modification or fabrication of that device which changes the customer's telephone number or which allows that customer to utilize a different utility service provider is subject to tax as set forth in Regulation 1546 (18 CCR 1546).~~

(c) BAD DEBT DEDUCTIONS.

(1) IN GENERAL. The provision of Regulation 1642, "Bad Debts" (18 CCR 1642) apply to retailers making sales of wireless telecommunications devices pursuant to subdivision (b)(1).

(2) CHARGE-BACKS TO THE RETAILER. Retailers reporting tax measured by the unbundled sales price of a wireless telecommunications device may take a bad debt deduction pursuant to Regulation 1642 when **consideration** ~~a payment or rebate~~ from a utility service provider is charged-back to the retailer based on a customer's termination of its contract with the utility service provider before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by retailer from the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the debt owed by the customer and the corresponding credit for excess tax reimbursement.

(3) RETAIL UTILITY TRANSACTIONS. Retailers of wireless telecommunication devices sold in a retail utilities transaction may take a bad debt deduction pursuant to Regulation 1642 when a customer terminates its utility service contract with the retailer before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by the retailer in connection with the sale of the wireless telecommunication device excluding any amounts collected from the customers as tax or tax reimbursement. The amount collected from the customer on the retail utility transaction shall be allocated among the total amount collected for both the wireless telecommunication device and utility service by dividing the unbundled sales price by the total amount the retailer would have collected if the customer fully performed under the terms of the utility service contract, and then multiplying that amount by the total amount collected by the retailer to date.

Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the bad debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the bad debt owed by the customer and the corresponding credit for excess tax reimbursement.

NOTE: Authority cited: Section 7051, Revenue and Taxation Code.

Reference: Sections 6006, 6010, 6011, 6012, and 6055, Revenue and Taxation Code.

Regulation 1585 - Cellular Telephones, Pagers, and Other Telecommunications Devices

Comparison Between Staff's Version and Industry's Suggested Changes

STAFF'S PROPOSED LANGUAGE	INDUSTRY'S PROPOSED CHANGES	COMMENTS
(a) DEFINITIONS.	(a) DEFINITIONS.	
(1) WIRELESS TELECOMMUNICATION DEVICE. A portable communication device such as a cellular telephone or pager requiring activation by a utility service provider or seller of utility services in order to send, receive, or send and receive transmissions via network of wireless transmitters throughout multiple service areas, or otherwise.	(1) WIRELESS TELECOMMUNICATION DEVICE. A portable communication device such as a cellular telephone or pager requiring activation by a wireless telecommunications ~~utility~~ service provider or seller of utility services in order to send, receive, or send and receive transmissions via network of wireless transmitters throughout multiple service areas, or otherwise.	Staff agrees to the proposed change.
(2) UTILITY SERVICE PROVIDER. A utility regulated by the Public Utilities Commission or the Common Carrier Bureau of the Federal Communications Commission which offers or provides wireless communication or paging services.	(2) WIRELESS TELECOMMUNICATIONS ~~UTILITY~~ SERVICE PROVIDER. A provider of commercial mobile radio services as defined in the Code of Federal Regulations under 47 CFR 20.3.~~A utility regulated by the Public Utilities Commission or the Common Carrier Bureau of the Federal Communications Commission which offers or provides wireless communication or paging services.~~	Staff disagrees with this proposal for the following reasons: 1) Proposed Regulation 1585 would be subject to definitional changes that may occur as a result of modifications to the CFR. For example, if 47 CFR 20.3 was modified by Congress or the FCC, the regulation would also be changed; and, 2) 47 CFR 20.3 does not appear to cover all aspects of wireless telecommunications as contemplated by proposed Regulation 1585.
(3) BUNDLED TRANSACTION. The retail sale of a wireless telecommunication device which requires the retailer's customer to contract with a utility service provider for utility service as a condition of that sale. A transaction is a bundled transaction within the meaning of this section without regard to the method in which the price is stated to the customer. Also, it is immaterial whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice.	(3) BUNDLED TRANSACTION. The retail sale of a wireless telecommunication device which requires the retailer's customer to activate or contract with a wireless telecommunications ~~utility~~ service provider for utility service as a condition of that sale. A transaction is a bundled transaction within the meaning of this section without regard to the method in which the price is stated to the customer. Also, it is immaterial whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice.	Staff agrees to the proposed change.

(4) UNBUNDLED SALES PRICE. The price at which a retailer would sell a specific wireless telecommunication device to a customer who is not required to activate or contract with a utility service provider for utility service as a condition of that sale. The unbundled sales price of a wireless telecommunication device shall equal the fair retail selling price of that device and shall be consistent with the industry's usual and customary retail pricing practices for the type of device sold.

(4) UNBUNDLED SALES PRICE. The price at which the ~~a~~ retailer would sell a specific wireless telecommunication device to a customer who is not required to activate or contract with a wireless telecommunications ~~utility~~ service provider for utility service as a condition of that sale. ~~The unbundled sales price of a wireless telecommunication device shall equal the fair retail selling price of that device and shall be consistent with the industry's usual and customary retail pricing practices for the type of device sold.~~

Staff believes this language should be left in, but that it could be modified to reflect the pricing practices of local retailers. Staff and industry do agree that the regulation should address the sale of discontinued and obsolete merchandise. Staff believes that industry "lined-out" language should be replaced with: "the unbundled sales price of a wireless telecommunications device shall equal the fair retail selling price of that device and shall be consistent with the usual and customary retail pricing practices of other local retailers for the type of device sold. The unbundled sales price of an obsolete wireless telecommunications device shall equal the actual selling price of that device." Staff also recommends that the words "would sell" on line one be changed to "has sold."

(5) CARRIER RESTRICTED TRANSACTION. The sale of a wireless telecommunication device which requires the customer purchasing the device to contract with one specific utility service provider for utility service as a condition of that sale. The customer purchasing the wireless telecommunication device is generally required to pay a predetermined fee to the utility service provider in the event that customer fails to obtain utility service from that utility service provider. The person providing the wireless telecommunication device to the customer does not receive a rebate or payment for obtaining the customer's contract with that utility service provider.

~~(5) CARRIER RESTRICTED TRANSACTION. The sale of a wireless telecommunication device which requires the customer purchasing the device to contract with one specific utility service provider for utility service as a condition of that sale. The customer purchasing the wireless telecommunication device is generally required to pay a predetermined fee to the utility service provider in the event that customer fails to obtain utility service from that utility service provider. The person providing the wireless telecommunication device to the customer does not receive a rebate or payment for obtaining the customer's contract with that utility service provider.~~

Industry proposes that the name for these types of transactions be changed to "Consignment Transactions" and that language defining these transactions be copied from a portion of industry's proposed revisions to subdivision (b)(3). Staff disagrees. These types of transactions are not always consignment sales in that the person transferring the device to the end-use customer often has title to the device. Industry's proposed definition also fails to recognize that the end-use customer is required to contract exclusively with a particular service provider as a condition of purchasing the wireless device. Staff does believe that the term "Carrier Restricted Transaction" should be replaced with the term "Exclusive Service Provider Transactions" for clarification purposes.

(6) RETAIL UTILITIES TRANSACTION. The combined retail sale of a wireless telecommunication device and utility service by a single retailer not affiliated with, or a part of, a utility service provider. The retailer of a wireless telecommunication device purchases utility service from a utility service provider for sale directly to its customer. Customers are required to contract for utility service from the retailer upon the sale of a wireless telecommunication device to that customer. The sales price listed on the customer's sales receipt or invoice for the wireless telecommunication device may or may not be below the retailer's acquisition cost of that device. The customer continues to pay the retailer for utility service throughout the duration of the utility service contract.

(6) RETAIL ~~UTILITIES~~ TRANSACTION. The combined retail sale of a wireless telecommunication device and utility service by a single retailer not affiliated with, or a part of, a wireless telecommunications ~~utility~~ service provider. The retailer of a wireless telecommunication device purchases utility service from a wireless telecommunications ~~utility~~ service provider for sale directly to its customer. Customers are required to contract for utility service from the retailer upon the sale of a wireless telecommunication device to that customer. The sales price listed on the customer's sales receipt or invoice for the wireless telecommunication device may or may not be below the retailer's acquisition cost of that device. The customer continues to pay the retailer for utility service throughout the duration of the utility service contract.

Industry proposes a different name for the definition of this type of transaction. Staff remains of the opinion that the word "utilities" is necessary for describing these types of transactions.

(b) APPLICATION OF TAX.

(1) IN GENERAL. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device. The retailer of the wireless telecommunication device is required to report and pay the tax.

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(1) IN GENERAL. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device. The retailer of the wireless telecommunication device is required to report and pay the tax.

(2) BUNDLED TRANSACTIONS AND RETAIL UTILITIES TRANSACTIONS. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction or in a retail utilities transaction, measured by the unbundled sales price of that device. Tax applies to the unbundled sales price whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice. The retailer of the wireless telecommunication device is required to report and pay tax measured by the unbundled sales

(2) BUNDLED TRANSACTIONS AND RETAIL ~~UTILITIES~~ TRANSACTIONS. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction or in a retail ~~utilities~~ transaction, measured by the unbundled sales price of that device. Tax applies to the unbundled sales price whether the wireless telecommunication device and utility service are sold for a single price or are separately itemized in the context of a sale or on a sales invoice. The retailer of the wireless telecommunication device is required to report and pay tax measured by the unbundled sales

Staff remains of the opinion that the word "utilities" is necessary for describing these types of transactions.

price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. Tax does not apply to the charges in excess of the unbundled sales price made for telecommunication services

price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. Tax does not apply to the charges in excess of the unbundled sales price made for telecommunication services

(3) CARRIER RESTRICTED TRANSACTIONS. The utility service provider is generally regarded as the retailer of the wireless telecommunication device notwithstanding any agreement or contractual obligation between the utility service provider and the person or entity providing the device to an end-use customer. Where the utility service provider reimburses or rebates money to a separate person or entity, that person or entity receiving the reimbursement or rebate is regarded as the retailer of the wireless telecommunication device. In either event, the person or entity regarded as the retailer of the wireless telecommunication device owes tax to the Board measured by the unbundled sales price of that device. The retailer may not collect tax or tax reimbursement from either the end-use customer or the person selling the device to the end-use customer.

(3) CONSIGNMENT ~~CARRIER RESTRICTED~~ TRANSACTIONS. Where ~~T~~the wireless telecommunications ~~utility~~ service provider retains title to the wireless communications device and consigns the wireless communications device to a third party for sale or lease to customers, that wireless telecommunications service provider is generally regarded as the retailer of the wireless telecommunication device notwithstanding any agreement or contractual obligation between the wireless telecommunications ~~utility~~ service provider and the person or entity providing the device to an end-use customer. Where the wireless telecommunications ~~utility~~ service provider provides consideration ~~reimburses or rebates money~~ to a separate person or entity, that person or entity receiving the consideration ~~reimbursement or rebate~~ is regarded as the retailer of the wireless telecommunication device. In either event, the person or entity regarded as the retailer of the wireless telecommunication device owes tax to the Board measured by the unbundled sales price of that device. If the retailer is the wireless telecommunications service provider, the wireless telecommunications service provider may reduce (or take credit for) the amount of California sales tax due using the unbundled price approach by the amount of sales tax paid by the consumer on the retail transaction.~~The retailer may not collect tax or tax reimbursement from either the end-use customer or the person selling the device to the end-use customer.~~

Industry continues to classify all transactions as consignment sales and proposes that two separate entities pay tax measured by a portion of the total amount collected from an end-use customer. (This would also mean that two separate entities would attempt to collect tax reimbursement from a single, end-use customer.) Staff disagrees with this proposal. As set forth in staff's response to subdivision (a)(5), not all transactions within this category are consignment sales. Staff further believes that allowing two different entities to report tax on a portion of the total amount collected from an end-use customer would create consumer protection problems as well as administrative difficulties in performing audits. One alternative is to allow the person deemed the retailer for the transaction to report tax measured by the entire unbundled sales price of the wireless telecommunications device.

(4) ACTIVATION FEES. Tax does not apply to a one-time charge for activating a new

~~(4) ACTIVATION FEES. Tax does not apply to a one-time charge for activating a new~~

Staff believes that industry no longer objects to the provisions of this subdivision. However, one other

wireless telecommunication device with, or on behalf of, a utility service provider where the charge is separately stated and is not for the electronic or physical modification of the device in order for it to function within a utility service provider's service network. A one-time charge for activating a wireless telecommunication device is subject to tax if the activation consists of the physical or electronic modification or fabrication of a wireless telecommunication device in order for the device to function within a utility service provider's service network. The person collecting this fee is required to report and pay tax on that amount. Any subsequent charge for the physical or electronic modification or fabrication of that device which changes the customer's telephone number or which allows that customer to utilize a different utility service provider is subject to tax as set forth in Regulation 1546 (18 CCR 1546).

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interested party has suggested that language be added to clarify what constitutes electronic modification.

(c) BAD DEBT DEDUCTIONS.

(1) IN GENERAL. The provisions of Regulation 1642, "Bad Debts" (18 CCR 1642), apply to retailers making sales of wireless telecommunication devices pursuant to subdivision (b)(1).

(c) BAD DEBT DEDUCTIONS.

(1) IN GENERAL. The provisions of Regulation 1642, "Bad Debts" (18 CCR 1642), apply to retailers making sales of wireless telecommunication devices pursuant to subdivision (b)(1).

(2) CHARGE-BACKS TO THE RETAILER. Retailers reporting tax measured by the unbundled sales price of a wireless telecommunication device may take a bad debt deduction pursuant to Regulation 1642 when a payment or rebate from a utility service provider is charged-back to the retailer based on a customer's termination of its contract with the utility service provider before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected

(2) CHARGE-BACKS TO THE RETAILER. Retailers reporting tax measured by the unbundled sales price of a wireless telecommunication device may take a bad debt deduction pursuant to Regulation 1642 when consideration ~~a payment or rebate~~ from a utility service provider is charged-back to the retailer based on a customer's termination of its contract with the utility service provider before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount

Industry proposes that the words "a payment or rebate" be substituted with the word "consideration." Staff disagrees with this proposal. The word consideration is a technical legal term, with a particular meaning and consequences. The regulation uses terms commonly understood in the business community, in accordance with rulemaking requirements.

and retained by the retailer from the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the debt owed by the customer and the corresponding credit for excess tax reimbursement.

(3) RETAIL UTILITY TRANSACTIONS. Retailers of wireless telecommunication devices sold in a retail utilities transaction may take a bad debt deduction pursuant to Regulation 1642 when a customer terminates its utility service contract with the retailer before the date specified in the utility service contract. The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by the retailer in connection with the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. The amount collected from the customer on the retail utility transaction shall be allocated among the total amount collected for both the wireless telecommunication device and utility service by dividing the unbundled sales price by the total amount the retailer would have collected if the customer fully performed under the terms of the utility service contract, and then multiplying that amount by the total amount collected by the retailer to date.

Any tax or tax reimbursement collected by the retailer

collected and retained by the retailer from the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. Any tax or tax reimbursement collected by the retailer on the amount of bad debt deduction claimed by the retailer constitutes excess tax reimbursement and must be returned to the customer or paid to the Board unless the customer and retailer agree that this amount may be applied toward the amounts owed by the customer on the debt. The customer and retailer will be regarded as having agreed to the application of any excess tax reimbursement to the customer's debt where the retailer's books reflect both the debt owed by the customer and the corresponding credit for excess tax reimbursement.

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Any tax or tax reimbursement collected by the retailer

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AFL-CIO

California School Employees Association

Michael Bilbrey
Association President

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Executive Director

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Tristan Brown
Legislative Advocate

Member of the AFL-CIO

The nation's largest independent classified employee association

The Honorable Jerome Horton, Chair
State Board of Equalization
450 N Street, MIC:72
Sacramento, CA 95814

Re: Opposition of the California Tax Reform Association to Petition to Repeal Sales and Use Tax Regulation 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*

Dear Chairman Horton:

The California School Employees Association (CSEA), AFL-CIO, joins your staff in opposition to the petition to Repeal Sales and Use Tax Regulation 1585, Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices.

When a wireless company sells a cell phone at a discounted price to a consumer, it does not lose profit. Instead of earning its mark-up on the sale of the phone, the company earns money by requiring the consumer to sign up for a new multi-year contract. The earnings from such a contract may exceed the earnings from the company's mark-up on the normal retail price of the phone.

Regulation 1585 addresses the application of the Sales and Use Tax Law to sales and purchases of wireless telecommunication devices. Regulation 1585 defines the sales price of a cell phone as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." (Reg. 1585, subd. (a)(4).)

As your staff noted, the Regulation is consistent with case law holding that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88. This rule is important because it guides the state to not permit companies to escape paying taxes by artificially transforming a clearly taxable transaction (sale of a phone) to another, possibly more lucrative transaction (in this case, the extended phone contract), and then also to claim an exemption from taxes.

The Legislature has on multiple occasions rejected efforts to change this rule. The annual loss to the General Fund of granting the exemption could total more than $300 million.

For these reasons, we respectfully urge your "No" vote against this petition. Please do not hesitate to call me if there are any questions regarding this issue at (916) 329-3623.

Sincerely,

Jai Sookprasert
Assistant Director of Governmental Relations

cc: All Members of the Board of Equalization
Dave Low, Executive Director

JS:sk

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BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

MARCH 26, 2015

CHIEF COUNSEL MATTERS

J RULEMAKING

J1 PETITION TO REPEAL SALES AND USE TAX

REGULATION 1585, CELLULAR TELEPHONES, PAGERS, AND

OTHER WIRELESS TELECOMMUNICATION DEVICES

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

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1 P R E S E N T

2

3 For the Board of Equalization: Jerome E. Horton
Chairman

4

5 Sen. George Runner (Ret.)
Vice Chairman

6

7 Fiona Ma, CPA
Member

8

9 Diane L. Harkey
Member

10

11 Yvette Stowers
Appearing for Betty T.
12 Yee, State Controller
(per Government Code
13 Section 7.9)

14

Joann Richmond
15 Chief
Board Proceedings
16 Division

17 For Staff: Bradley Heller
Tax Counsel IV
18 Legal Department

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20 ---oOo---

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California Tax Reform Association
4

5 Daniel Hattis 5
Attorney
6 Hattis Law

7 ---oOo---

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1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 MARCH 26, 2015
4 ---oOo---
5 MR. HORTON: Ms. Richmond, our next case,
6 please -- item.
7 MS. RICHMOND: Our next item is Chief
8 Counsel Matters. Item J Rulemaking; J1 Petition to
9 Repeal Sales and Use Tax Regulation 1585, Cellular
10 Telephones, Pagers and Other Wireless
11 Telecommunication Devices.
12 And we do have speakers for this item, but
13 I believe one has left.
14 MR. HORTON: Members, I would ask --
15 note that the spe- -- I would ask the speakers to
16 come forward, those that are here.
17 Daniel Hattis.
18 MR. HATTIS: Yes, Hattis.
19 MR. HORTON: Hattis, my apologies.
20 And Samantha Corbin.
21 Ms. Corbin is with the California Tax
22 Reform Association. And Mr. Hattis is attorney with
23 Hattis and Law.
24 Please come forward to my left, please.
25 To my left.
26 MR. HATTIS: To your left.
27 MR. HORTON: And welcome to the Board of
28 Equalization. I'll take the testimonies first.

1 ---oOo---
2 ED HOWARD
3 ---oOo---
4 MR. HOWARD: Mr. Chairman, Members, I am
5 not in fact Samantha Corbin. My name is Ed Howard
6 with the California Tax Reform Association. Good
7 afternoon.
8 We submitted written comments in opposition
9 to granting the petition. We really don't have a
10 whole lot to add to what we think is an excellent
11 staff analysis. But for all of the reasons stated
12 in the staff analysis, we do believe the petition is
13 not well-founded. And not only not well-founded
14 lawfully but would also result in a very significant
15 impact to the General Fund. And we would encourage
16 you to respectfully reject the petition.
17 MR. HORTON: Sir.
18 ---oOo---
19 DANIEL HATTIS
20 ---oOo---
21 MR. HATTIS: Okay. Mr. Chairman, Board
22 Members, my name is Dan Hattis. I'm an attorney.
23 I'm here on behalf of my client Ms. Lee and on
24 behalf of your constituents, the consumer taxpayers,
25 who bear the brunt of this unlawful tax.
26 Regulation 1585 is bad policy, one of the
27 most unpopular and confusing regulations out there
28 and affects everyone.

1 Actually the reasons why it's bad policy,
2 Senator Runner has -- has done an excellent in a
3 letter he wrote in 2011 to Assemblyman Garrett in
4 support of a bill to avoid that. I've actually got
5 copies of that here, but I'm not going to focus on
6 the policy.
7 The main problem with the bill is that --
8 I'm sorry, the regulation, is that it's
9 unconstitutional and it institutes a tax beyond the
10 scope of the Board's authority.
11 The Board staff is hiding something from
12 you and they're hoping that you don't notice and
13 that I don't expose it.
14 As the rulemaking file for Regulation 1585
15 reflects and in their memorandum given to you today,
16 the Board staff gives only one legal justification
17 for Regulation 1585, that the tax charged on the,
18 quote, "unbundled sales price" under 1585 is the
19 same amount that would have been charged anyway even
20 if 1585 didn't exist; that is, that it's not an
21 additional tax.
22 That even without 1585 there's two payment
23 streams to the retailer of cellular phones: One,
24 the consumer pays money at the point of sale, let's
25 say $199 for an iPhone; and then two, there's a
26 commission from the wireless service provider four
27 hundred and 50 bucks. And that both of those are
28 gross receipts under 6012. And that accounting for

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1 these streams is a burden and for a, quote,
2 "administrative ease," use of the unbundled price --
3 which is equivalent anyways because say the
4 unbundled price is 650, you add those two, 199 plus
5 450 is 650, it's good enough and it's reasonable to
6 do that.
7 There -- there's a huge flaw in the staff's
8 argument. The scenario the staff describes where
9 there's a consumer payment to the retailer and a
10 commission from the wireless provider only occurs in
11 a minority of the transactions, those that are third
12 party retailers like Best Buy. In fact, 66 percent
13 of cell phones are sold direct in carrier-owned
14 stores; i.e. the Verizon store, the AT&T store
15 T-mobile, Sprint. That's a statistic from the NPD
16 study in 2010.
17 Like in the case of my client Ms. Lee, the
18 AT&T store is where she bought her phone, direct,
19 paid 199 to AT&T and zero commission was paid. AT&T
20 did not pay a commission to itself. There were no
21 gross receipts per tax section 6012 beyond the 199
22 paid for the phone.
23 My question for the Chief Counsel's office
24 is the question the Board staff has avoiding and
25 hiding and praying for years that no one would ever
26 answer -- ask. And that is, what is the legal
27 rationale for charging sales tax on more than the
28 $199 that was paid to AT&T? Where do you find the

1 additional $450 of gross receipts per section 6012
2 of the code?
3 I anticipate that the staff is going to
4 respond that they want to reclassify some of the
5 service revenue for product. Well, first, that's
6 not allowed, and it ends up to be double taxation.
7 I think all of you probably have cell
8 phones and you probably get your bills. And you
9 notice there's a lot of tax on your cell phone bill.
10 In fact, there's a tax of approximately six -- 16
11 percent, 16.04 percent of tax. And that's on
12 services.
13 And so if the Board is going to argue here
14 that we want to reclassify $450 of what was paid for
15 cell phone service as -- as product, well, first,
16 they don't have the power to do that. You can only
17 do what -- you know, what you're empowered to do.
18 And second, well, we got paid 16 percent in taxes on
19 service. The federal government, all the state
20 agencies, the PUC, the city government, all have
21 been taxing it as service. That's double taxation.
22 And in fact, if that actually goes through and that
23 was approved, I'm going to have to go after, on
24 behalf of the constituents, all of the other folks
25 and say you guys overcharged tax because this is on
26 product, not service.
27 Second, there's another grounds for vio- --
28 that the regulation should be voided, and that's a

1 procedural one. The Board staff did not perform a
2 sufficient economic impact study. The staff
3 outright misrepresented to the Board and the Office
4 of Administrative Law -- and this was in 1997, and
5 there -- and '98, when they presented it -- and they
6 said that there was going to be no revenue impact
7 and no additional tax burden under the regulation.
8 And you'll see this in the rulemaking file, which I
9 requested and I read entirely through.
10 Yet the staff has, in fact, admitted in an
11 offhand comment -- and it's actually in the issue
12 paper before you -- that it knew there was an
13 impact, quote, the service providers also agreed --
14 and the service providers are the carriers -- also
15 agreed to this pricing structure as they did not
16 want two standards giving them a competitive
17 advantage over retailers.
18 That is, the staff just offhandedly
19 admitted that under 1585 the carriers are going to
20 pay more sales tax than they would have otherwise.
21 This failure to honestly assess the economic impact
22 is independent grounds on its own per the recent
23 2013 supreme court Western State's Petroleum to void
24 the regulation entirely.
25 It appears the staff's sole effort to
26 assess the economic impact was to ask the carriers,
27 "Hey, carriers, do you care if we apply this tax to
28 you and increase your -- increase the sales tax you

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1 have to charge?"
2 And the carriers said, "No, we don't care.
3 We pass it through to consumers anyway."
4 Well, I'll tell you who cares, your
5 constituents care, the consumer taxpayers who brunt
6 the force of the tax care and they were never
7 represented in the process.
8 MS. RICHMOND: Time's expired.
9 MR. HATTIS: Okay. If you indulge me, I
10 have just maybe 30 seconds more.
11 MR. HORTON: Uh, yes, go ahead.
12 MR. HATTIS: I appreciate it.
13 I also hope the Board asks me some
14 questions or grants me some additional time to
15 explain my plans regarding filing a class action
16 lawsuit, which I will be filing against the Board to
17 recover the overpaid sales taxes on behalf of your
18 constituents, the consumer taxpayers.
19 Now, today you have the opportunity to
20 revoke 1585 before a court does it for. As Board
21 Members, I urge you not to be on the wrong side of
22 history here. Don't put yourself in a position of
23 having to explain to your constituents why you voted
24 here today after finally getting the full story of
25 this tax and its legality and still upvoting to
26 uphold this illegal tax that consumers bear the
27 brunt of. A tax that I can assure you is
28 consequently going to be found unconstitutional and

1 invalid on its face.
2 MR. HORTON: Thank you.
3 Welcome, Mr. Heller. Would you please
4 introduce yourself for the record in the case --
5 MR. HELLER: Sure. Thank you, Mr.
6 Horton.
7 MR. HORTON: -- the matter before us.
8 MR. HELLER: Good afternoon, Chairman
9 Horton, Members of the Board. I'm Bradley Heller
10 from the Board's Legal Department.
11 I'm here to provide the Legal Department's
12 recommendation that the Board deny the petition from
13 Ms. Lee requesting that the Board repeal Regulation
14 1585, cellular telephones, pagers and other wireless
15 telecommunication devices or the portions of the
16 regulation clarifying the measure of tax with regard
17 to sales of wireless telecommunication devices and
18 bundled transaction.
19 In her petition, Ms. Lee expresses her
20 belief that the regulation is inconsistent with the
21 statutory definition of gross receipts in Revenue
22 and Taxation Code Section 6012. Ms. Lee has
23 standing to bring this petition under the California
24 Administrative Procedure Act and the Board is
25 required to take a timely action on the petition.
26 As relevant here, Revenue and Taxation Code
27 Section 6012 provides that gross receipts mean the
28 total amount of the sale or lease or rental price of

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1 the retail sales of retailers valued in money,
2 whether received in money or otherwise.
3 Section 6012 further provides that the
4 total amount of the sale or lease price includes any
5 services that are part of the sale, all receipts,
6 cash, credits or any -- excuse me, all receipts,
7 cash, credits, and property of any kind, and any
8 amount for which credit is allowed by the seller to
9 the purchaser.
10 And the California courts' and the Board's
11 longstanding interpretation of section 6012 are that
12 retailer's gross receipts include all of the
13 retailer's receipts from the sale of tangible
14 personal property, not solely amounts that the
15 retailer actually received directly from a consumer.
16 This longstanding interpretation is also
17 the basis for the Board's rules regarding
18 manufacturer coupons and rebates and incentives
19 issued by manufacturers to retailers which also
20 result in third party considera- -- third party
21 payments included in retailer's gross receipts as
22 set forth in Regulation 1671.1, Discounts, Coupons,
23 Rebates and Other Incentives.
24 A retailer commonly sells wireless
25 telecommunication devices to customers in one of two
26 different ways:
27 The retailer will sell the -- will sell the
28 device to a customer for a fair retail selling

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1 price, which includes the retailer's wholesale cost
2 for the device, plus a markup to cover the
3 retailer's expenses and provide a profit in an
4 unbundled transaction in which the customer is not
5 required to activate or contract for wireless
6 telecommunication services as a condition of the
7 sale.
8 The retailer will also sell the same device
9 to a customer for a discounted price in a bundled
10 transaction in which the customer is required to
11 activate or contract for cellular service as a
12 condition of the sale, and the retailer will give
13 the customer the discount because the retailer will
14 receive a rebate or commission from a wireless
15 telecommunications provider for selling the device
16 to the customer for the discounted price with the
17 wireless telecommunication services.
18 When a wireless telecommunications device
19 is sold in an unbundled transaction, Regulation 1585
20 provides that sales or use tax applies to the actual
21 gross receipts received by the retailer from the end
22 use customer from the sale of that device because
23 those are the retailer's only gross receipts from
24 such sale.
25 When a wireless telecommu- -- excuse me,
26 wireless telecommunication device is sold in a
27 bundled transaction, Regulation 1585 provides that
28 the sales or use tax will still apply to the

1 unbundled sales price of the device which is the
2 actual price at which the retailer sold the same
3 wireless telecommunication device to customers who
4 are not required to activate service or contract for
5 service as a condition of the sale. And this
6 measure counts for both the consideration received
7 from the end use customer for the sale of that
8 device and the rebate or commission from the
9 wireless telecommunication service provider for
10 selling the device at a discounted price.
11 In addition, when a retailer has not made
12 any unbundled sales of the device to use as a direct
13 and objective measure of tax, Regulation 1585
14 provides needs certainty to retailers and retailer's
15 customers by providing the tax applies to the fair
16 retail selling price of the device, which is
17 generally the wholesale cost of the device to the
18 retailer plus an 18 percent markup.
19 Regulation 1585's provisions providing the
20 sales and use tax applies to the unbundled sales
21 price of wireless telecommunications devices sold in
22 bundled transactions are reasonable and consistent
23 with the definition of gross receipts in Revenue and
24 Taxation Code 6012 as interpreted by the courts and
25 the Board.
26 Ms. Lee's petition only generally alleges
27 that Regulation 1585 conflicts with Section 6012.
28 It does not quote any specific portion of the

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1 Section 6012, and it merely makes the assertion that
2 Revenue and Taxation -- excuse me, that the Revenue
3 and Taxation Code requires that all sales taxes are
4 to be calculated based on the gross receipts
5 retailers actually receive at the point of sale,
6 which is just not an accurate interpretation of the
7 law.
8 Moreover, the Petitioner -- excuse me, the
9 petition does not provide any new information
10 regarding the consideration that retailers receive
11 from wireless telecommunication service providers
12 for selling devices at discounted prices and bundled
13 transactions. Therefore, the petition provides no
14 basis for the Legal Department to recommend changes
15 to the regulation.
16 Furthermore, the Legal Department's opinion
17 is that the repeal of Regulation 1585 by itself
18 would not necessarily reduce the measure of tax
19 regarding sales of wireless telecommunication
20 devices and bundled transaction. This is because
21 tax would still apply to all of the retailer's gross
22 receipts from the sale of such devices, including
23 payments from wireless telecommunication service
24 providers for selling the devices at discounted
25 prices. And that would be true whether based upon
26 general application of the statutory definition of
27 gross receipts as interpreted by the courts and the
28 Board, or by application of the existing provisions

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1 of Regulation 1671.1.

2 Therefore, the Legal Department is

3 concerned that the repeal of sec- -- regulation

4 1585.5 -- excuse me, 1585, excuse me, by itself

5 would create unnecessary confusion and might even

6 increase the measure of tax in some bundled

7 transactions.

8 It should also be noted that Regulation

9 1585 provides a reasonable brightline rule that

10 facilitates ease of reporting, and that industry has

11 supported and continues to support this brightline

12 rule.

13 In addition, I just wanted to mention that,

14 although they're not present today, we did also

15 receive a letter from the Assistant Director of

16 Governmental Relations for the California School

17 Employees Association, which is a member of the

18 AFL-CIO. And the letter provided CSEA's and

19 AFL-CIO's opposition to the petition.

20 And just in response to the comments that

21 I've heard so far this morning, there is authority

22 to -- to tax -- to apply tax to services that are a

23 part -- or, excuse me, to include in the measure of

24 tax charges for services that are part of the sale

25 of tangible personal property.

26 Staff's certainly not hiding anything.

27 And, you know, the actual rulemaking file has been

28 made available, so I don't know -- I don't think

Electronically signed by Kathleen Skidgel (601-100-826-6264) 13e84dcf-e058-487e-a2d7-c21cc8442f13

1 there's anything to be hidden here.
2 And we still don't have anything specific
3 that explains that there's been any change in the --
4 the commissions and rebate, so I don't see how we
5 could recommend a change in the measure of tax based
6 on the change and the practice in the industry.
7 And honestly, I don't believe that what
8 I've heard today actually clearly explains that
9 every single -- or that there are retail outlets
10 that are being operated directly by the wireless
11 communication service providers under the exact same
12 entity or that this is like a general practice in
13 the industry.
14 So at this point I did not hear anything
15 that would change the Legal Department's opinion.
16 MR. HORTON: Discussion, Members?
17 Mr. Runner.
18 MR. RUNNER: Yeah. You know, and again, I
19 think you rightfully observed that there's been a
20 series of pieces of legislation that deal with this
21 issue of which I, quite frankly, feel is the right
22 way to deal with it. And I think that that is the
23 best way for the -- the -- the nuances of the law in
24 light of its unique issues in its application to the
25 statute and -- and to be dealt with on the
26 legislative path, which is why I continue to support
27 any kind of bills in the Legislature that do that.
28 The challenge that I think we have before

1 us is a little bit different. And that is -- and
2 let me just -- because I'm -- I'm concerned about,
3 as we would move forward with that issue, the -- the
4 likelihood or the potential of some unintended
5 consequences without clear legislative direction in
6 regards to how to deal with that in terms of the
7 fact that there could be -- I mean there is going to
8 be some discussion as to how to fill the void as you
9 clearly have a tangible good.
10 I mean, I think we sometimes talk about the
11 fact of what do you do with a -- you know, a hundred
12 dollar phone that may be worth $300, but the -- and
13 what's the real value, and can debate that. But the
14 real question is, what do you do with a free phone?
15 Because, clearly, a free phone has value to it. And
16 you don't get a free phone unless you actually
17 attach it to a contract.
18 So there was clearly, in terms of the law,
19 a exchange of tangible good there. And you've got
20 to figure out somehow how to value that. And I
21 think that's the challenge that we have. So that's
22 my concern in regards to trying to deal with it
23 here. How -- what would -- what would it be
24 replaced with in regards to out there? And I think
25 that's the unintended consequence I'm concerned
26 about. That's why I do continue to believe that the
27 Legislature is the best place to address this issue.
28 I think it's always important for us to

1 address whether or not the current process that we
2 have for assessment is indeed the way that the
3 practice is actually going on in the businesses
4 themselves. And it might be time, at some point,
5 for us to look at that, to see if what's happening
6 in regards to how phones are purchased and bought
7 and financed is actually what -- reflected in our --
8 in our -- in our regulations.
9 As we all know, things change. And how it
10 is that something was done when this regulation was
11 placed may not be the normal process that people are
12 really buying and selling phones today.
13 So those would be my observations and why I
14 don't feel comfortable in just removing that as a
15 regulation today, but certainly need to continue to
16 both work with the Legislature and for us to review
17 internally what it is that we may want to look at.
18 MR. HORTON: Member Harkey.
19 MS. HARKEY: Thank you, very much.
20 I reviewed this extensively and there were
21 two court cases, one which -- one is Yabsley --
22 Yabsley versus Cingular, the other is Loeffler
23 versus Target, and I believe they speak to a similar
24 issue or support what was done.
25 I think it's -- for our consumers, it's
26 confusing because they think they're getting a free
27 phone. But if you didn't do that, and we have no
28 other way of -- of assessing what the actual value

1 of the component is, if we don't have another
2 regulation to replace this regulation, it could be
3 the wild west. You could have a -- a one-year
4 contract or a two-year contract and pay taxes on the
5 entire contract and then get a free phone, which is,
6 in most cases, probably more than what has been
7 negotiated.
8 I asked for an explanation as to how this
9 was contrived. How -- how did we reach this? And I
10 think you've explained it very, very well. And this
11 is how it was explained to me.
12 So I think maybe a marketing effort is more
13 to the point. I also believe that -- that the
14 phones are now -- now a lot of phones are sold as a
15 unit. You pay your $600 and you can exchange and do
16 things as you need, but you're not -- bundles are
17 kind of going by the wayside, as I understand it. I
18 think there's -- there's an increasing desire to get
19 the latest and greatest phone on an annual basis.
20 So I think that, without anything else in
21 place, we'd be hard-pressed to just repeal this and
22 throw it out. And I do believe the courts would
23 support us in that. And I believe that the
24 explanation as to how this 1585 was arrived, how we
25 arrived at what we charge, how we charge, what is to
26 be charged for sales tax, made perfect sense once it
27 was explained to me.
28 I think the problem is, is that people see

1 "free phone" and they expect free phone. But that's
2 not -- the program is you buy the phone with --
3 because nobody is going to sell a phone or anything
4 else for less than they -- less than it costs them.
5 That's not the purpose of being in business. So
6 there's got to be something else with it. And as
7 you explained, there's the coupon and the
8 reimbursement from -- for the service.
9 So I can't support the petition right now,
10 but I wish you luck.
11 MR. HORTON: Further discussion, Members?
12 Is there a motion?
13 MS. HARKEY: I move to deny the petition.
14 MR. HORTON: Member Harkey moves to deny
15 the petition, second by Member Stow- -- Ma.
16 Without objection, Members, such will be
17 the record.
18 Thank you very much.
19 ---oOo---
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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

8 the California State Board of Equalization certify

9 that on March 26, 2015 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 1 through 21 constitute

14 a complete and accurate transcription of the

15 shorthand writing.

16

17 Dated: March 13, 2015

18

19

20 Kathleen Skidgel

21 KATHLEEN SKIDGEL

22 Hearing Reporter

23

24

25

26

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Electronically signed by Kathleen Skidgel (601-100-826-6264) 13e84dcf-e058-487e-a2d7-c21cc8442f13

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. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2015-0410-04		

For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

APR 10 '15 APR 24 '15

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
Cellular Telephones, Pagers, and Other Wireless	18	1585	April 24, 2015

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
☐ Notice re Proposed Regulatory Action ☒ Other	Richard E. 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 January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))
- ☐ 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

TITLE 18. BOARD OF EQUALIZATION

NOTICE OF DECISION REQUIRED BY GOVERNMENT CODE SECTION 11340.7

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board's Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)
>
> When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg.

1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms "sales price" and "gross receipts" so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

> (a) "Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
> (b) The total amount of the sale or lease or rental price includes all of the following:
> (1) Any services that are a part of the sale.
> (2) All receipts, cash, credits and property of any kind.
> (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board's long-standing interpretation of RTC section 6012 is that "'[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs." (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court's and the Board's long-standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88 [gross receipts included non-mandatory tips paid to retailer's waitresses for serving food to the extent waitresses agreed to credit the tips against retailer's obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer's coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

[¶] . . . [¶]

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark-up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long-standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

[¶] . . . [¶]

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale." The current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

Prior to the March meeting, the Board received a letter from Mr. Jai Sookprasert, Assistant Director of Governmental Relations for the California School Employees Association (CSEA), which is a member of the AFL-CIO. In the letter, Mr. Sookprasert stated that the CSEA and AFL-CIO join Board "staff's opposition to the petition." Mr. Sookprasert agrees with Board staff that Regulation 1585 "is consistent with case law holding that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer." Mr. Sookprasert also expresses the CSEA's and AFL-CIO's opinion that Regulation 1585 "is important because it guides the state to not permit companies to escape paying taxes by artificially transforming a clearly taxable transaction (sale of a phone) to another, possibly more lucrative transaction (in this case, the extended phone contract), and then also to claim an exemption from taxes."

During the hearing on March 26, 2015, the Board considered the petition. The Board heard comments from Mr. Ed Howard, from the California Tax Reform Association (CTRA), who said that the CTRA opposes the petition. The Board heard comments from Mr. Daniel Hattis, petitioner's attorney, in support of the petition and the petitioner's request that the Board repeal Regulation 1585. The Board also heard comments from Board staff, which explained why the Board's Legal Department concluded that Regulation 1585 is consistent with RTC section 6012. At the conclusion of the hearing, the Board Members unanimously voted to deny the petition because the Board agreed that that Regulation 1585 is consistent with RTC section 6012 for the reasons set forth in the March 12, 2015, Chief Counsel Memorandum.

Interested persons have the right to obtain a copy of the petition from the Board and may do so by contacting 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. A copy of the petition is also available on the Board's website at www.boe.ca.gov.

Questions regarding this matter should be directed to Mr. Bradley 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 Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

(Grosse *et al.*, 2013). Therefore both substances qualify for listing via Labor Code section 6382(b)(1).

An explanation of the carcinogenicity classifications used by IARC, and the *Monographs* development and peer review by the international working groups of scientific experts convened by IARC, may be found at the following URL: http://monographs.iarc.fr/ENG/Preamble/CurrentPreamble.pdf.

Identity of chemicals: *Aloe vera*, also known as *Aloe barbadensis* Miller, is one of approximately 420 species of Aloe plants. Other common names of *Aloe vera* are Barbados aloe, Mediterranean aloe, True aloe, and Curaçao aloe. Whole leaf extract of *Aloe vera* is commonly referred to as whole leaf *Aloe vera* juice or Aloe juice. Whole leaf extract of *Aloe vera* is the liquid portion of the *Aloe vera* leaf (e.g., what remains after removal of fibrous material, such as lignified plant fibers), and is a natural constituent of the *Aloe barbadensis* Miller plant. *Aloe vera* whole leaf extract is not the same as *Aloe vera* decolorized whole leaf extract, *Aloe vera* gel, *Aloe vera* gel extract, or *Aloe vera* latex, which would not be covered by this proposed listing.

Goldenseal is also known as *Hydrastis Canadensis*, orangeroot, Indian turmeric, and curcuma, but it should not be confused with turmeric *(Curcuma longa* Linn.). Goldenseal root powder is the powdered dried roots and underground stems of goldenseal plants. Goldenseal root powder is a natural constituent of the goldenseal plant.

Opportunity for comment: OEHHA is providing this opportunity to comment as to whether the chemicals identified above meet the requirements for listing as causing cancer specified in Health and Safety Code section 25249.8(a) and Labor Code section 6382(b)(1). Because these are ministerial listings, comments should be limited to whether IARC has identified the specific chemical or substance as a known or potential human or animal carcinogen. Under this listing mechanism, OEHHA cannot consider scientific arguments concerning the weight or quality of the evidence considered by IARC when it identified these chemicals and will not respond to such comments if they are submitted.

OEHHA must receive comments by 5:00 p.m. on Tuesday, May 26, 2015. 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, and should include "NOIL" and the chemical name in the subject line. Comments submitted in paper form may be mailed, faxed, or delivered in person to the address below.

Mailing Address: Ms. Esther Barajas-Ochoa
Office of Environmental Health Hazard Assessment
P.O. Box 4010, MS-19B
Sacramento, California 95812-4010
Fax: (916) 323-2265
Street Address: 1001 I Street
Sacramento, California 95814

Comments received during the public comment period will be posted on the OEHHA website after the close of the comment period.

If you have any questions, please contact Esther Barajas-Ochoa at Esther.Barajas-ochoa@oehha.ca.gov or at (916) 445-6900.

References

Grosse Y, Loomis D, Lauby-Secretan B, El Ghissassi F, Bouvard V, Benbrahim-Tallaa L, Guha N, Baan R, Mattock H, Straif K, on behalf of the International Agency for Research on Cancer Monograph Working Group. (2013). Carcinogenicity of some drugs and herbal products. *The Lancet Oncology.* Published online July 5, 2013, doi: 10.1016/S1470-2045(13)70329-2. [URL: http://www.thelancet.com/journals/lanonc/article/PIIS1470-2045%2813%2970329-2/fulltext.

International Agency for Research on Cancer (IARC, 2015). Agents Classified by the *IARC Monographs*, Volumes 1-112. Last update: March 23, 2015. Available at URL: http://monographs.iarc.fr/ENG/Classification/ClassificationsAlphaOrder.pdf [Accessed April 1, 2015].

RULEMAKING PETITION DECISION

BOARD OF EQUALIZATION

NOTICE OF DECISION REQUIRED BY GOVERNMENT CODE SECTION 11340.7

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title

18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board's Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)
>
> When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg. 1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms "sales price" and "gross receipts" so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

> (a) "Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
>
> (b) The total amount of the sale or lease or rental price includes all of the following:
>
> (1) Any services that are a part of the sale.
>
> (2) All receipts, cash, credits and property of any kind.
>
> (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board's long–standing interpretation of RTC section 6012 is that " '[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs." (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court's and the Board's long–standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of*

Equalization (1947) 82 Cal.App.2d 88 [gross receipts included non–mandatory tips paid to retailer's waitresses for serving food to the extent waitresses agreed to credit the tips against retailer's obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer's coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

[¶]...[¶]

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark–up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long–standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

[¶]...[¶]

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale." The current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

Prior to the March meeting, the Board received a letter from Mr. Jai Sookprasert, Assistant Director of Governmental Relations for the California School Employees Association (CSEA), which is a member of the AFL–CIO. In the letter, Mr. Sookprasert stated that the CSEA and AFL–CIO join Board "staff's opposition to the petition." Mr. Sookprasert agrees with Board staff that Regulation 1585 "is consistent with case law holding that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer." Mr. Sookprasert also expresses the CSEA's and AFL–CIO's opinion that Regulation 1585 "is important because it guides the

state to not permit companies to escape paying taxes by artificially transforming a clearly taxable transaction (sale of a phone) to another, possibly more lucrative transaction (in this case, the extended phone contract), and then also to claim an exemption from taxes."

During the hearing on March 26, 2015, the Board considered the petition. The Board heard comments from Mr. Ed Howard, from the California Tax Reform Association (CTRA), who said that the CTRA opposes the petition. The Board heard comments from Mr. Daniel Hattis, petitioner's attorney, in support of the petition and the petitioner's request that the Board repeal Regulation 1585. The Board also heard comments from Board staff, which explained why the Board's Legal Department concluded that Regulation 1585 is consistent with RTC section 6012. At the conclusion of the hearing, the Board Members unanimously voted to deny the petition because the Board agreed that Regulation 1585 is consistent with RTC section 6012 for the reasons set forth in the March 12, 2015, Chief Counsel Memorandum.

Interested persons have the right to obtain a copy of the petition from the Board and may do so by contacting 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. A copy of the petition is also available on the Board's website at www.boe.ca.gov.

Questions regarding this matter should be directed to Mr. Bradley 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 Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279–0082.

DISAPPROVAL DECISIONS

DECISION OF DISAPPROVAL OF REGULATORY ACTIONS

Printed below are the summaries of Office of Administrative Law disapproval decisions. The full text of the disapproval decisions is available at www.oal.ca.gov under the "Publications" tab. You may also request a copy of a decision by contacting the Office of Administrative Law, 300 Capitol Mall, Suite 1250, Sacramento, CA 95814–4339, (916) 323–6225 — FAX (916) 323–6826. Please request by OAL file number.

CALIFORNIA HORSE RACING BOARD

State of California
Office of Administrative Law

In re:
CALIFORNIA HORSE RACING BOARD

REGULATORY ACTION:
Title 4, California Code of Regulations

AMEND SECTION 1689.1

DECISION OF DISAPPROVAL OF REGULATORY ACTION

(Gov. Code, sec. 11349.3)

OAL File No. 2015–0305–01S

SUMMARY OF REGULATORY ACTION

The California Horse Racing Board (Board) proposed to amend section 1689.1, Safety Vest Required, of title 4 of the California Code of Regulations. The proposed amendment would provide that no pony rider shall pony or lead a horse or be mounted on a horse on the grounds of a racing association, racing fair, or authorized training facility unless wearing a safety vest. On March 5, 2015, the Board submitted the proposed amendment to the Office of Administrative Law (OAL) for review in accordance with the Administrative Procedure Act (APA). On April 7, 2015, OAL sent a Notice of Disapproval of the proposed regulatory action. This Decision of Disapproval of Regulatory Action explains the reasons for OAL's action.

DECISION

OAL disapproved the above referenced regulatory action for failure to comply with the "clarity" standard of Government Code section 11349.1.

CONCLUSION

For the reasons set forth above, OAL has disapproved this regulatory action. If you have any questions, please contact me at (916) 323–6808.

Date: April 10, 2015

Craig Tarpenning

CRAIG S. TARPENNING
Assistant Chief Counsel
For: DEBRA M. CORNEZ
Director

Original: Rick Baedeker
cc: Nicole Lopes–Gravely

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change <Legal.Regulations@BOE.CA.GOV>
Sent: Friday, April 24, 2015 3:03 PM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement Denial of Petition to Repeal Regulatory 1585

The State Board of Equalization received a petition requesting that the Board repeal Sales and Use Tax Regulation 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*. The Board conducted a hearing regarding the petition on March 26, 2015, and the Board voted to deny the petition at the conclusion of the hearing.

To view the petition, the Chief Counsel Memorandum regarding the petition, and the notice of denial click on the following link: http://www.boe.ca.gov/regs/reg_1585_2015.htm.

Please DO NOT REPLY to this message, as it was sent from an "announcement list."

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Technical Problems: If you cannot view the link included in the body of this message, please contact the Board's webmaster at webmaster@boe.ca.gov<mailto:webmaster@boe.ca.gov>

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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SEN. GEORGE RUNNER (RET.)
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Second District, San Francisco

JEROME E. HORTON
Third District, Los Angeles County

DIANE L. HARKEY
Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

April 27, 2015

Daniel Hattis
Hattis Law
2300 Geng Road, Suite 200
Palo Alto, CA 94303

Re: Petition to Repeal Regulation 1585

Dear Mr. Hattis:

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board's Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of

tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)

When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg. 1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms "sales price" and "gross receipts" so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

> (a) "Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
> (b) The total amount of the sale or lease or rental price includes all of the following:
> (1) Any services that are a part of the sale.
> (2) All receipts, cash, credits and property of any kind.
> (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board's long-standing interpretation of RTC section 6012 is that "'[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such

services might not appear to directly relate to production or sale costs." (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court's and the Board's long-standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88 [gross receipts included non-mandatory tips paid to retailer's waitresses for serving food to the extent waitresses agreed to credit the tips against retailer's obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer's coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

[¶] . . . [¶]

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark-up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long-standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

[¶] . . . [¶]

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that

sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale." The current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

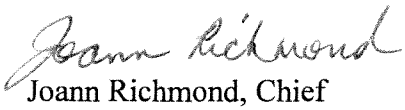
Prior to the March meeting, the Board received a letter from Mr. Jai Sookprasert, Assistant Director of Governmental Relations for the California School Employees Association (CSEA), which is a member of the AFL-CIO. In the letter, Mr. Sookprasert stated that the CSEA and AFL-CIO join Board "staff's opposition to the petition." Mr. Sookprasert agrees with Board staff that Regulation 1585 "is consistent with case law holding that a retailer's gross receipts include all of the retailer's receipts from the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer." Mr. Sookprasert also expresses the CSEA's and AFL-CIO's opinion that Regulation 1585 "is important because it guides the state to not permit companies to escape paying taxes by artificially transforming a clearly taxable transaction (sale of a phone) to another, possibly more lucrative transaction (in this case, the extended phone contract), and then also to claim an exemption from taxes."

During the hearing on March 26, 2015, the Board considered the petition. The Board heard comments from Mr. Ed Howard, from the California Tax Reform Association (CTRA), who said that the CTRA opposes the petition. The Board heard comments from you, as petitioner's attorney, in support of the petition and the petitioner's request that the Board repeal Regulation 1585. The Board also heard comments from Board staff, which explained why the Board's Legal Department concluded that Regulation 1585 is consistent with RTC section 6012. At the conclusion of the hearing, the Board Members unanimously voted to deny the petition

because the Board agreed that Regulation 1585 is consistent with RTC section 6012 for the reasons set forth in the March 12, 2015, Chief Counsel Memorandum.

If you have any questions, please contact me at (916) 322-9569.

Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:bh:reb

cc: Honorable Jerome E. Horton, Chairman
Senator George Runner (Ret.), Vice Chair
Honorable Fiona Ma, CPA, Second District
Honorable Diane L. Harkey, Fourth District
Honorable Betty T. Yee, State Controller

bc: Ms. Shellie Hughes – MIC: 72
Ms. Kari Hammond – MIC: 72
Mr. Sean Wallentine – MIC: 78
Mr. Jim Kuhl – MIC: 71
Mr. Russell Lowery – MIC: 77
Ms. Yvette Stowers – MIC: 73

Ms. Cynthia Bridges – MIC: 73
Mr. Randy Ferris – MIC: 83
Mr. Jeffrey McGuire – MIC: 43
Mr. Bradley Heller – MIC: 82
Ms. Kim Rios – MIC: 50

STATE OF CALIFORNIA

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State Controller

CYNTHIA BRIDGES
Executive Director

April 27, 2015

To Interested Parties:

TITLE 18. BOARD OF EQUALIZATION

NOTICE OF DECISION REQUIRED BY GOVERNMENT CODE SECTION 11340.7

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board's Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700,

subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)

When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg. 1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

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> (b) The total amount of the sale or lease or rental price includes all of the following:
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As relevant here, the Board's long-standing interpretation of RTC section 6012 is that "'[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs." (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court's and the Board's long-standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from

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[¶] . . . [¶]

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[¶] . . . [¶]

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> current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

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During the hearing on March 26, 2015, the Board considered the petition. The Board heard comments from Mr. Ed Howard, from the California Tax Reform Association (CTRA), who said that the CTRA opposes the petition. The Board heard comments from Mr. Daniel Hattis, petitioner's attorney, in support of the petition and the petitioner's request that the Board repeal Regulation 1585. The Board also heard comments from Board staff, which explained why the Board's Legal Department concluded that Regulation 1585 is consistent with RTC section 6012. At the conclusion of the hearing, the Board Members unanimously voted to deny the petition because the Board agreed that that Regulation 1585 is consistent with RTC section 6012 for the reasons set forth in the March 12, 2015, Chief Counsel Memorandum.

Interested persons have the right to obtain a copy of the petition from the Board and may do so by contacting 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. A copy of the petition is also available on the Board's website at www.boe.ca.gov.

Questions regarding this matter should be directed to Mr. Bradley 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 Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE OF CALIFORNIA

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DIANE L. HARKEY
Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

April 27, 2015

To Interested Parties:

TITLE 18. BOARD OF EQUALIZATION

NOTICE OF DECISION REQUIRED BY GOVERNMENT CODE SECTION 11340.7

On Monday, February 23, 2015, the State Board of Equalization (Board) received a petition dated February 18, 2015, from Ms. Jenny Lee (petitioner), pursuant to Government Code section 11340.6, requesting that the Board repeal California Code of Regulations, title 18, section (Regulation or Reg.) 1585, *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*, or, alternatively, that the Board repeal subdivisions (a)(3) and (4), (b)(3) through (6), and (c) of Regulation 1585. The petition requested that the Board repeal the regulation or the portions of the regulation clarifying the measure of tax with regard to sales of wireless telecommunications devices in "bundled" transactions because petitioner asserted that the regulation is inconsistent with the statutory definition of "gross receipts" in Revenue and Taxation Code (RTC) section 6012.

RTC section 7051 authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law (RTC, § 6001 et seq.), and the Board adopted Regulation 1585 pursuant to that authority.

The Board's Legal Department reviewed the petition and prepared a Chief Counsel Memorandum dated March 12, 2015, which recommended that the Board deny the petition in its entirety because Regulation 1585's provisions clarifying the measure of tax with regard to sales of wireless telecommunications devices in bundled transactions are consistent with the definition of "gross receipts" in RTC section 6012 and judicial precedent interpreting that definition. The memorandum explained that:

> California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700,

subd. (a)(1).) If a retailer collects sales tax reimbursement that is computed on an amount that is not taxable or on an amount in excess of the taxable amount, the retailer is required to return the excess amount paid to the customer. (RTC, § 6901.5; Reg. 1700, subd. (b).)

When sales tax does not apply, use tax is imposed, measured by the sales price of property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (RTC, § 6202.) Every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the Board, and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Reg. 1684.) However, a consumer remains liable for reporting and paying use tax to the Board when the use tax is not paid to a retailer that is registered to collect the tax. (Reg. 1685, subd. (a).) In addition, RTC section 6901 expressly provides for the Board to refund overpaid use tax to a consumer that reported and paid the use tax to the Board, and for the Board to refund directly to a consumer "[a]ny overpayment of the use tax by [the consumer] to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor." (RTC, § 6901; Reg. 1685, subd. (a).)

RTC sections 6011 and 6012 similarly define the terms "sales price" and "gross receipts" so that the measure of tax is substantially the same with respect to sales and use tax transactions. In relevant part, RTC section 6012, subdivisions (a)(1) and (2), and (b)(1) through (3), expressly provide that:

> (a) "Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of . . . (1) The cost of the property sold. . . . [or] (2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.
> (b) The total amount of the sale or lease or rental price includes all of the following:
> (1) Any services that are a part of the sale.
> (2) All receipts, cash, credits and property of any kind.
> (3) Any amount for which credit is allowed by the seller to the purchaser.

As relevant here, the Board's long-standing interpretation of RTC section 6012 is that "'[s]ervices that are a part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs." (See, e.g., Sales and Use Tax Annotation [footnote omitted] 295.1690 (8/16/78).) Also, the California court's and the Board's long-standing interpretations of RTC section 6012 are that a retailer's gross receipts include all of the retailer's receipts from

the sale of tangible personal property, not solely amounts that the retailer actually received directly from a consumer. (See, e.g., *Anders v. State Board of Equalization* (1947) 82 Cal.App.2d 88 [gross receipts included non-mandatory tips paid to retailer's waitresses for serving food to the extent waitresses agreed to credit the tips against retailer's obligation to pay minimum wage]; Sales and Use Tax Annotation 295.0430 (5/9/73) [amount received from a manufacturer as reimbursement for accepting the manufacturer's coupon from the customer is included in gross receipts].) In addition, retailers may collect sales tax reimbursement from their customers on the full amount of their gross receipts from the sale of tangible personal property, including amounts received from third parties, if their contracts of sale so provide. (Sales and Use Tax Annotation 295.1045 (3/11/93).)

[¶] . . . [¶]

It is a common practice in the wireless telecommunication industry for a retailer to offer to sell a wireless telecommunication device for a fair retail price (cost plus a mark-up) and for the retailer to offer to sell the same device for a discounted price if the sale of the device is coupled (or bundled) with the purchase of wireless telecommunication service because the wireless service provider will indirectly reimburse the retailer for giving the consumer a discount on the device, similar to the manner in which a manufacturer may reimburse a retailer for accepting the manufacturer's coupon. However, this practice first started to become prevalent after the California Public Utilities Commission reversed the long-standing ban against "bundling" in 1995. Board staff worked closely with retailers of wireless telecommunication devices and wireless telecommunications service providers to provide clear and administratively efficient guidance regarding the application of the Sales and Use Tax Law to sales of wireless telecommunications devices in bundled transactions when the practice was new. Thus, the provisions ultimately included in Regulation 1585, which the Board adopted on October 15, 1998, are the result of a collaborative effort between retailers of wireless telecommunication devices, wireless telecommunications service providers, and the Board.

[¶] . . . [¶]

As relevant here, the current provisions of subdivision (a)(4) of Regulation 1585 define the unbundled sales price of a wireless telecommunication device as the actual "price at which the retailer has sold [such] specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale." The current provisions of subdivision (a)(3) of Regulation 1585 clarify for retailers that a bundled transaction is an agreement for the sale of a wireless telecommunication device that "contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale." The

> current provisions of subdivision (b)(3) of Regulation 1585 also clarify for retailers that, in bundled transactions where the customers are paying the retailers a discounted sales price for a wireless telecommunication device and wireless telecommunications service providers are paying the retailers rebates or commissions for selling the devices at discounted prices with the required services, the retailers' gross receipts from the sale of the devices are limited to the unbundled sales prices of the devices as determined from actual sales, and do not include any amounts in excess of the unbundled sales prices. In addition, the current provisions of subdivision (a)(4) of Regulation 1585 provide an objective and administratively efficient way of reporting tax for retailers who cannot establish the unbundled sales price of a wireless telecommunication device by looking at an actual unbundled sale of the device. Subdivision (a)(4) provides that these retailers shall report and pay tax on the fair retail selling price of the device, which is equal to the cost of the device plus a markup on cost of at least 18 percent.

The Board scheduled a hearing on the petition for March 26, 2015, and made the petition and the March 12, 2015, Chief Counsel Memorandum available to the public as an attachment to the Board's public agenda notice for its March 25 and 26, 2015, meeting.

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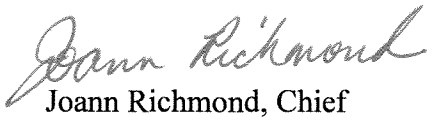
Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:reb