

220,0211 with In Personam Jurisdiction
12/24/87 Rationale. (325.0193)

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the Petition
for Redetermination Under the
Sales and Use Tax Law

DECISION AND RECOMMENDATION

[Redacted]

[Redacted]

Petitioner

The above entitled matter came on regularly for hearing on November 6, 1987, in Sacramento, California, before Stephen A. Ryan, Hearing Officer.

Appearing for Petitioner:

Appearing for the Board: Mr. Landon Carter
Senior Tax Auditor

Protested Items

On January 21, 1987, petitioner filed a petition for redetermination of a Notice of Determination issued by the Board on December 30, 1986, for the period July 1, 1982 through June 30, 1985. The protest involves tax deficiencies determined on the following audit items:

	<u>Measure</u>
A. "Taxable sales understated"	\$111,554

Petitioner's Contentions

1. No tax liability or use tax collection liability exists because:

(i) No nexus exists.

(ii) Petitioner had no office and did not engage in business in California.

(iii) Petitioner is not a retailer engaged in business in California pursuant to Revenue and Taxation Code sections 6015 or 6203.

(iv) The transaction is excluded from California use tax under Regulation 1620(b)(3) because the diamonds sold were obtained and used by the purchasers outside California for more than 90 days before initial entry into California.

Summary

Petitioner is a [redacted] corporation which sells diamonds and jewelry to customers located throughout the United States. It has possessed a Certificate Of Registration-Use Tax from the Board since August 30, 1982. This was the first Board audit.

The Board's field auditor in the out-of-state office prepared a four-page report dated February 6, 1986 as part of his work papers which generally described his findings on petitioner and its activities. He found that petitioner operated out of state selling jewelry and diamonds to customers who desired them for personal use or investment. Petitioner had no locations or inventory in California. It solicited sales in California through mailers, magazine advertisements, and independent sales representatives located in California known as "financial planners" who received commissions for sales generated by them.

The field auditor examined the portion of petitioner's records which petitioner made available to him and discovered numerous sales to California purchasers. He wrote that he examined sales orders, cash receipts journal #1, cash receipts journal #2, and an accountant's work papers. He wrote that he was unable to verify when petitioner began selling to California purchasers because petitioner "refused to provide books and records and other information necessary for verification of the starting date."

Schedule 12A prepared by the field auditor identified 47 California retail sales to California purchasers which he concluded subjected the gross receipts of petitioner to California "sales tax". Based upon the evidence made available to him, he found that 43 of these sales involved a shipment of the property sold directly from out of state to the California purchaser. He found that the property sold in the other four sales was first shipped by petitioner to the [redacted] Trust Company in Delaware. His description of the tangible personal

property sold includes the following: round diamonds, diamonds, small diamonds, diamond ring, wedding band, diamond earrings, stud earrings, diamond pendant, diamond ring set, bracelet, gold ring set, and jewelry.

The auditor found that petitioner maintained a "custodial account" with [redacted] for petitioner's customers who wished "to have their diamonds kept in safe keeping." He wrote that [redacted] would only subsequently ship the property to a California purchaser pursuant to a written request from petitioner and not solely at the request of any purchaser.

The auditor found that petitioner did not ship any products sold to any location until it received full payment from the purchaser. He added that "[w]hen payment is received, taxpayer makes an entry in cash receipts journal #2 in the exchange section which would indicate that the sale is final and item should now be shipped."

On Schedule 414A prepared by the field auditor on February 5, 1986, he wrote as follows: Information was conveyed to auditor that California sales were consummated through financial planners in state which TP pays a commission to for respective sales made by them."

The auditor concluded that petitioner was liable for California sales tax measured by its gross receipts generated from these sales. He concluded that none of this property was functionally used outside California while owned by any California purchaser.

Board supervising auditor [redacted] in the office prepared a report dated March 5, 1986 which is also contained in the audit work papers. He concluded that the California purchaser became liable for California use tax upon receipt of the property in California. He added that in the transactions involving initial delivery to the [redacted] the sale by petitioner did not occur until the property was shipped by [redacted] to the California purchaser. He also described a telephone conversation with [redacted] when he was informed that the California financial planners referred potential California customers to petitioner for which they received commissions.

Board Auditor [redacted] wrote in a memorandum dated February 2, 1987 that petitioner retained ownership and control over the property held for safe keeping by the [redacted]. He identified that petitioner delivered the property to [redacted] Trust Company in sealed

containers. He wrote that petitioner paid all charges made by _____ with the California purchasers not paying for any storage, shipment, or other costs. He reiterated that petitioner had to request _____ to ship property to the California purchasers and that such shipment would not be made solely upon a California purchaser's request. He added that shipments to the California customers were by common carrier. He concluded that there was no functional use of the property outside California.

Board reviewing auditor _____ in Sacramento met with _____ and obtained additional evidence in several transactions which apparently was not previously submitted to the field auditor. He deleted 11 sales from the measure of the audit deficiency. He concluded that five sales were for resale and that six sales involved property which had never entered into California. These deletions included all four transactions which the field auditor found involved initial delivery to Delaware. The new evidence indicated that one other sale (_____) involved property initially shipped to Delaware but this remained in the audit deficiency. After _____ work was completed, the Notice of Determination was issued for use tax collection liability measured by the \$111,554 sales prices on the remaining 36 sales.

At the preliminary hearing, auditor _____ informed the hearing officer that the Board is holding petitioner liable for failing to collect and remit the use taxes on the 36 remaining transactions in which it sold diamonds and/or jewelry to California customers. He said that the products sold in 35 of these 36 transactions had been delivered directly from out of state into California based upon the evidence made available to the Board. He said that this information indicates that only one of these sales (the sale of four diamonds to _____) involved a prior delivery to the _____ from petitioner's _____ location prior to delivery to California.

_____ explained the reasons why the Board denied petitioner's claim of exemption under the 90-day rule in Regulation 1620(b)(3) in the _____ transaction involving initial delivery to _____. He found that such sale from petitioner to a California customer occurred at the time the _____ delivered the goods to a carrier for shipment to California. He concluded that the _____ acted as an agent for petitioner in holding petitioner's property. He said that _____ had told him that petitioner paid _____ the fees for maintaining the custodial account. Thus, he concluded that

no out-of-state use by _____ for more than 90 days had occurred.

_____ said that petitioner's representatives were not cooperative with the Board's field auditor which resulted in the lack of evidence on various points.

_____ initially spoke to the hearing officer in July of 1987. He argued that no nexus exists between his client and the State of California. He then submitted a letter dated October 2, 1987 attaching copies of documents of the _____ transaction and of his prior letter dated February 6, 1986 to the Board's _____ office.

_____ represented therein that the diamonds sold to _____ were first delivered by petitioner to the _____ in Delaware. He argued that petitioner made the sale at the time petitioner shipped the package containing the diamonds to _____. _____ has written that petitioner delivered the diamonds to _____ at _____ request. He believes that _____ had her diamonds in _____ for her rather than for petitioner. _____ contends that _____ maintained "exclusive control" over the diamonds while held by _____ with petitioner holding no possession, ownership, dominion, or control over them. He concluded that _____ is excluded from California use tax under Regulation 1620(b)(3) because her purchase was for investment purposes with the diamonds used outside California during the time _____ had possession for more than 90 days before first entering into California.

_____ wrote that petitioner's "procedure when it sells a diamond to a customer who requests that it be delivered to _____ in _____ is as follows:

1. The Company sells the diamond and delivers a bill of sale to the purchaser.
2. At the time of the sale, the purchaser instructs the company to deliver the diamonds to _____ to be held in a custodial account in the name of the purchaser.
3. The company sends the diamond in a box to _____ and receives a receipt for the diamond which is stated to be the 'pink-owner copy.'

4. The Company delivers the pink owner's copy to the purchaser and retains a customer invoice.

5. When the purchaser desires to sell or transfer the diamond, the purchaser delivers the pink owner's copy, duly endorsed to the Company and the Company in turn forwards it along with its customer invoice to [redacted].
[redacted] then sends the diamond directly to the owner.

The specific documents presented by [redacted] on the [redacted] matter include the following:

1. A November 19, 1981 letter from [redacted] to [redacted] of petitioner regarding petitioner's Custody Account 20417. She set forth some of the terms of their separate "agreement" regarding this account. Petitioner would send sealed packages containing diamonds to [redacted] for storage in its safe deposit box for a fee to be paid by petitioner. She requested that petitioner notify [redacted] of the name and address of the "owner" of the property prior to delivery to [redacted]. She identified labeling a receipt as a "miscellaneous asset". She acknowledged that [redacted] would ship the diamonds to the "owner" upon request and receipt of certain documentation from petitioner.

2. A June 1, 1983 letter from the president of petitioner, [redacted] to [redacted] notifying the latter that petitioner sent the four diamonds in a sealed box to [redacted] Company to be held in the name of [redacted]. He further indicated the [redacted] would hold the property "in safekeeping".

3. A June 10, 1983 receipt from [redacted] acknowledging receipt and storage with it of the package in custodial account number 20417 "to be delivered to [redacted] or to the owner certified by [redacted] name and address were identified thereon.

4. A June 14, 1983 "Customer Transaction Advice" on [redacted] stationery identifying "account [redacted] for [redacted] and the package.

5. A June 23, 1983 letter from petitioner to [redacted] regarding these four diamonds identifying the enclosure of the following: (i) copies of petitioner's letter of instruction to [redacted]; (ii) [redacted] as "official receipt" for the property; (iii) petitioner's "paid invoice"; and (iv) original [redacted] and Gem Audit Certificates.

6. A June 23, 1983 document on petitioner's stationery addressed to [redacted] but without a salutation. [redacted] name but without a signature was at the end of the two paragraph content of the document. It indicated a sale to [redacted] of the diamonds. It added "[a]bove described diamonds are being held in safekeeping, under the name of [redacted] at [redacted]"

A Statement of Account for [redacted] which was further identified as a Principal Asset Summary as of June 30, 1982 for account [redacted] was listed as "agent under agreement dated November 4, 1981 with [redacted] The approximate market value, percent of market value, estimated annual total, and the cash income yield for "miscellaneous assets" were listed as zero.

8. Page six of an undated Statement of Account of [redacted] for account [redacted] indicated two diamond custody receipts of [redacted] "representing" sealed packages for diamonds held by two people one of whom was [redacted]

9. A handwritten letter dated November 2, 1983 apparently containing a signature of a [redacted] to [redacted] which reads that she requested release of the diamonds to her with delivery to California.

10. A November 14, 1983 letter from petitioner to [redacted] requesting [redacted] to ship the diamonds via insured (\$25,620) registered mail to [redacted] in California. Petitioner referenced that [redacted] had "requested that her stones . . . being held in [redacted] Custodial Account [redacted], be released and forwarded to her." Petitioner indicated that it

enclosed "the pink Owner invoice and the yellow Customer invoice" to _____

11. A copy of a September 14, 1986 letter from _____ to petitioner providing that these four diamonds were purchased for investment and that the intended first use in California was investment and not for jewelry or any other purpose.

The November 4, 1981 Agreement between petitioner and the _____ Company provides that _____ would act as "custodian" for petitioner to hold for safekeeping sealed packages of diamonds. _____ agreed to hold each package until instructed by petitioner to deliver it according to instructions received from petitioner. _____ agreed to create a separate account for each package according to petitioner's instructions and to issue quarterly statements. Petitioner agreed to compensate _____ for its services and to indemnify it for loss, cost, or other damage arising out of the proper services of _____ Trust Company.

The Board's files on petitioner indicate that on August 30, 1982, _____ as corporate president of petitioner, signed an Application For Certificate Of Registration--Use Tax with the Board. It was represented on that application that petitioner was manufacturing, jobbing, or wholesaling diamonds in California as of July 1, 1982 through its sales representative, _____ of _____ California. _____ expressly certified that this information was correct and, further, that if petitioner was not engaged in business in California, petitioner agreed to comply with the provisions of the use tax laws, rules, and regulations in consideration for receiving the certificate of registration from the Board.

The hearing officer requested _____ to submit the identity of each California representative and other information regarding its relationship with each, including _____ Such information was not received.

Analysis and Conclusions

Petitioner apparently made no direct physical contact with this State through its own offices, business locations, or employees. However, it made use of non-employee representatives who were located inside this State for the purpose of soliciting its sales and possible taking orders for sales of tangible personal property.

The field auditor found that each sale occurred ~~in~~ ^{out of} ~~state~~ with the diamonds and/or jewelry still located ~~in~~ ^{out of} ~~state~~ at the time petitioner received full payment from the purchaser.

The available evidence indicates that the property sold by petitioner in all but the _____ transaction was delivered directly from ~~in~~ ^{out of} ~~state~~ to the California customers apparently by common carrier or postal service.

It is our conclusion that each sale occurred at the time petitioner received full payment and shipped the goods from its _____ location. Prior to occurrence, petitioner merely recorded an agreement to sell but retained ownership and control over the diamonds/jewelry. When it received full payment, petitioner relinquished ownership and control over the goods by recording the sale in its cash receipts journal #2, preparing the "pink owner invoice", and shipping them.

The various documentation in the _____ transaction indicates that this result also applies when the goods were first shipped by petitioner to the trust company in _____. The documents clearly identify _____ as the owner of the diamonds during the time the trust company held them in a safe deposit box. _____ had elected to have these apparently unfinished diamonds stored with the trust company. This is evidence to support her purchase for investment use rather than for physical use. Since these diamonds were used/stored outside California for more than 90 days prior to the first entry into this State, _____'s subsequent California use was excluded from California use tax (see Regulation 1620(b)(3)). Therefore, petitioner had no liability to collect any tax from her or to pay the Board on her transaction.

The available evidence appears to indicate that petitioner is not liable for California sales tax on the remaining 35 sales as was concluded by the field auditor. The incomplete evidence presented to the hearing officer indicates that deliveries were made from ~~in~~ ^{out of} ~~state~~ by common carrier or the postal service directly to the California purchasers. When sales do not occur in California, California "sales tax" does not apply (see Rev. & Tax. Code §§ 6051, 6017, and 6010.5; and Regulation 1620(a)). [This conclusion would not apply and petitioner could be liable for California sales tax if the delivery of the property initially was to one or more of its representatives inside California who then delivered the goods to the California customer.]

California use tax liability is incurred by a person who purchases tangible personal property from a retailer for use, storage, or other consumption in California (Rev. & Tax.

Code §§ 6201 and 6202). A retailer engaged in business in this State who makes a sale to such a purchaser is required to collect the use tax at the time of the sale (Rev. & Tax. Code § 6203). The retailer then must remit the taxes so collected to the Board (Rev. & Tax. Code § 6204).

Revenue and Taxation Code section 6203 defined "retailer engaged in business in this state" as follows during the period in question:

(a) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business.

(b) Any retailer having any representative, agent, salesman, canvasser or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property.

(c) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

Since petitioner had representatives inside California for the purposes of soliciting sales and taking orders, it was a retailer engaged in business in this State. It is of no consequence that the persons soliciting were not employees (see Scripto v. Carson (1960) 362 U.S. 207, 4 L.Ed.2d 660, 80 S.Ct. 619). Accordingly, it had a duty under the Sales and Use Tax Law to collect and remit the use tax.

Petitioner's concerns about nexus as it relates to the Board's power to require it to collect and remit use tax in light of the Constitution of the United States have been dealt with in numerous decisions of the U.S. Supreme Court and lower federal courts as well as state courts. The issues have revolved around the Due Process Clause of the Fourteenth Amendment as to a state's power to require an out-of-state seller to collect use tax as well as the acquisition of in personam jurisdiction over the out-of-state retailer. An additional issue has concerned the Commerce Clause of the U.S. Constitution.

On the substantive jurisdictional issue arising from the Due Process Clause, the constitutional test which must be

met to establish the requisite nexus is whether the facts demonstrate some definite link, some minimum connection between the state and the retailer (see National Geographic v. Cal. Equalization Bd. (1977) 430 U.S. 551, 51 L.Ed.2d 631, 97 S.Ct. 1386; Hess v. Illinois (1967) 386 U.S. 753, 18 L.Ed.2d 505, 87 S.Ct. 1389; Scripto v. Carson, supra; and Miller Bros. v. Maryland (1954) 347 U.S. 340, 98 L.Ed. 744, 74 S.Ct. 535). This is not a direct tax upon petitioner but an administrative duty to collect the use tax from its purchasers and pay it to the Board. It is well settled that, under appropriate circumstances, a retailer's presence within a taxing state will warrant the imposition of an obligation to collect use tax from a purchaser and pay such amount to that State when goods are sold out-of-state but delivered into that state (see National Geographic, supra; Scripto, supra; General Trading Co. v. Tax Commission (1944) 322 U.S. 335, 88 L.Ed. 1309, 65 S.Ct. 1028; Nelson v. Montgomery Ward (1941) 312 U.S. 373, 85 L.Ed. 897, 61 S.Ct. 593; Nelson v. Sears, Roebuck & Co. (1941) 312 U.S. 359, 85 L.Ed. 888, 61 S.Ct. 586; Felt and Tarrant Mfg. Co. v. Gallagher (1938) 306 U.S. 62, 83 L.Ed. 488, 59 S.Ct. 376; Monamotor Oil Co. v. Johnson (1934) 292 U.S. 86, 78 L.Ed. 1141, 54 S.Ct. 575; People v. West Publishing Co. (1950) 35 Cal.2d 80, 216 P.2d 441; and Montgomery Ward and Co. v. State Board of Equalization (1969) 272 Cal.App.2d 728, 78 Cal.Rptr. 373).

It is clear that a retailer is not required to collect this use tax from a California purchaser when its only contact with the State of California is via the U.S. mail and common carriers who deliver solicitation materials, orders, payments, and the goods purchased (Hess, supra). On the other end of the spectrum, it has been established that the retailer must collect use tax from California purchasers when it has an office or representatives (employee or independent contractor, resident or nonresident) in this State conducting continuous business here (see National Geographic, Scripto, General Trading, Sears v. Nelson, Felt and Tarrant, and West Publishing).

It is our conclusion that petitioner had the requisite constitutional link/connection/nexus with the State of California sufficient to allow the Board to require it to collect use tax on its sales to California purchasers and remit it to the Board in accordance with the Sales and Use Tax Law provisions. Although the exact date when petitioner actually began its physical presence in California is not known, it is clear that, through its agents and representatives, petitioner has maintained a continuous presence.

A similar conclusion results from an examination of these facts to the requirements of the Commerce Clause. the

courts in National Geographic, Scripto, Hess, Miller Bros., General Trading, and Felt & Tarrant Mfg. Co., all considered this issue and found that no burden is placed upon interstate commerce when only use tax collection is at issue rather than a direct (sales) tax on the retailer as long as an adequate constitutional link/connection/nexus exists as required by due process.

The result is that petitioner had a duty to collect use tax from all purchasers acquiring property from it for use in California (sections 6203 and 6204). Petitioner is liable to the Board for failing to remit such amounts from each sale outside California for California use (see sections 6204, 6201, and 6011).

One further constitutional consideration is necessary-- in personam jurisdiction over petitioner to enforce these use tax collection and remittance liabilities. This question arises from the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution and the leading case of International Shoe Co. v. Washington (1945) 326 U.S. 310, 90 L.Ed. 95, 66 S.Ct. 154. We have already examined the numerous U.S. Supreme Court cases which specifically examined the states' power to impose indirect use tax collection and payment duty liabilities on retailers in light of the Due Process Clause. Several of the courts specifically discussed the "jurisdiction" necessary before these liabilities could be imposed (see particularly Miller Bros.). The various terms set forth by these courts to describe the jurisdiction necessary for the taxing state to impose these liabilities included "link", "minimum connection", "contacts", "relationship", "nexus", and "substantial presence". Each court basically employed a balance test to determine if the retailer had enough contact with the state wherein it derived the right to significant benefits therein to justify these tax burdens. A test is thus necessary in each case to determine if this jurisdiction exists before a state can impose either of these liabilities.

None of the courts ever discussed the practical matter of a state seeking to collect these debts from the retailer. It appears that since the Due Process Clause allowed jurisdiction in the sense of the power of the states to impose these taxes and duties, it was a foregone conclusion that a state could thus enforce its powers and collect the funds.

The Miller Bros. court was one of the first to concern itself with this due process subject regarding use tax collection/payment. It continually referred to the states taxing "power or jurisdiction" and specifically stated that if "some jurisdictional fact or event" existed "as a conductor",

the state's taxing power or jurisdiction could reach beyond the borders of the states to reach its "extra territorial income or transactions" of the "nonresident" retailer (pages 342-343). It then set forth the basic due process test of a definite link/minimum connection between the state and the person, or property (pages 344-345). For one full page, the court examined the various factors of the retailer which might provide the jurisdiction to tax or impose the use tax collection/payment duties (page 345). This specifically included "[c]ertain activities or transactions carried on within a state, such as the use and sale of property" [Footnote citations omitted.]

The International Shoe decision considered the issue of whether or not the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution prohibits a nonresident corporation from being amenable to an in-state court action to enforce an unemployment tax obligation of the corporation arising out of its activities in that state. The out-of-state company contended that it was not present in the state and therefore the state court lacked in personam jurisdiction to subject it to a state tax or a suit for its collection (pages 315-316). The court held that:

. . . due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum he have certain minimum contacts with it such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." (Page 316.)

The court examined the nature, quality, and circumstances of the acts of the corporate out-of-state company within the taxing state. It noted that the "presence" within the state by a corporation was manifested by the activities carried on in its behalf by agents authorized to act for it. It found that single, occasional, casual, and irregular acts were insufficient contacts for due process purposes. It found that the systematic and continuous sales solicitation activities of eleven resident commissioned salesmen were sufficient minimum contacts for due process purposes in that case. The in personam action to enforce and collect the tax was allowed based upon personal service on an in-state solicitor and substituted service of the company by registered mail in accordance with the applicable state statutes.

A recent California appellate decision in Rocklin de Mexico, S.A. v. Superior Court (1984) 157 Cal.App.3d 91, 203

Cal.Rptr. 547, held the following about the status of jurisdiction in this state:

California's "long-arm" statute extends the jurisdiction of California courts to the outermost boundaries of due process. "A court of this state may exercise jurisdiction on any basis not inconsistent with the constitution of this state or of the United States." (Code Civ. Proc., § 410.10; see Sibley v. Superior Court (1976) 16 Cal.3d 442, 445 [128 Cal.Rptr. 34, 546 P.2d 322. (At page 94.)

Therefore, these case law interpretations of the constitutional limits are controlling.

The interesting state of the law is that the almost identical tests--"minimum contacts" versus "definite link, minimum connection"--have evolved from the U.S. Supreme Court decisions both on the power/jurisdiction of the state to impose the use tax collection duty and on the right and power to acquire in personam jurisdiction of the tax collector to enforce collection of such liabilities.

Since we have found that the Board has the power to impose these liabilities upon petitioner along the lines of the use tax collection cases, we also must conclude that in personam jurisdiction over petitioner exists in California sufficient to allow the Board to enforce these laws and collect on the debts.

We also conclude that petitioner was under a contractual obligation to collect use tax from these California purchasers and to remit those funds to the Board as a result of its execution of the certificate of registration application on August 30, 1982. Petitioner failed to perform this obligation and is separately responsible for these amounts.

Recommendation

Delete the Levine sales price from the deficiency. Redetermine without any further adjustment.

Stephen A. Ryan
Stephen A. Ryan, Hearing Officer

12-24-87
Date