STATE OF CALIFORNIA

220.0009

BOARD OF EQUALIZATION

APPEALS DIVISION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: V--- LABORATORIES, INC. Dba P--- L--- Center Petitioner	))))))))	HEARING DECISION AND RECOMMENDATION No. SR --- XX-XXXXXX-010

The above-referenced matter came on regularly for hearing before Hearing Officer Stephen A. Ryan on September 19, 19XX in Santa Ana, California.

Appearing for Petitioner:	Mr. V--- V--- President
Appearing for the Department of Business Taxes	Ms. Mary Kelly Tax Auditor
	Mr. Gerald Highland Supervising Tax Auditor

Protested Item

The protested tax liability for the period January 31, 1983 through December 31, 1985 is measured by:

Item

A. Sales tax on the estimated retail selling price of property allegedly sold in retail sales under Revenue and Taxation Code section 6007 - - disallowed resale deductions claimed on tax returns:

State, Local and County	BART	SMCT	SCTA	SCCT
$566,662	$30,600	$10,200	$6,801	$40,800

SCMT	LACT
$10,767	$240,264

Petitioner's Contention

Petitioner has no liability. All petitioner's sales are for resale. Petitioner's customers are liable for California sales tax since they each are engaged in business in California by regularly using petitioner to manufacture, store, and distribute goods.

Summary

Petitioner manufactures and sells various products, including cleaning solvents, insecticides, deodorants, and floor coatings. It has a manufacturing plant at XXXXX --- Lane, --- ---, California. It also has three out-of-state manufacturing plants. This was the first Board audit.

During the audit period, petitioner reported all of its $2,917,935 gross receipts as excluded from tax as being from sales which were made for resale.

The field auditor was not at the hearing. The audit workpaper comments indicated as follows regarding this deficiency matter: Petitioner made sales to "chemical companies and distributors" which were located outside California and not "registered to do business in California". We hereinafter refer to these "chemical companies and distributors" as "companies" or "company". Petitioner did not physically transfer any product to these companies. Petitioner "drop ships orders through common carrier" to customers ("consumers") of the companies. The consumers were located in California. Petitioner did not obtain any resale certificates. Petitioner's invoices and attached bills of lading indicate that it charged the companies for the product sold and for "freight charges". The invoices indicate title to the products passed to the companies F.O.B. petitioner's California plant. Petitioner made a delivery of the products to each California consumer of the "unregistered" companies, thereby constituting retail sales under Revenue and Taxation Code section 6007. The auditor apparently marked up petitioner's prices charged to the companies in the 1985 test period by 100 percent in order to set the estimated charge by the companies to the consumers, which is the "retail selling price" under section 6007.

An example invoice (partial copy) dated December 20, 1985 plus the attached copies of four bills of lading which are found in the audit workpapers indicate as follows: Petitioner listed a sale of four types of products to a New York company. Petitioner charged for the products sold. For two of those products, petitioner also charged $3.00 each for "UPS freight charges". It also charged $2.50 for "surcharge- - less than minimum" for one product. One provision read as follows: "Notice- - Title to goods passes to buyer after pickup on F.O.B. plant shipments. Please contact carrier for any shortage or damage. Do not deduct shortage or damage from invoice." The bills of lading indicate that UPS received goods from the New York company at XXXXX --- ---, --- ---, California (on December 10, 1985 and December 12, 1985) for consignment to four consumers. Three of those consumers were in California. The fourth was in Washington. It is written that freight was to be billed to the New York address of the New York company. Petitioner was not mentioned in the bills of lading.

The schedule (12-A1) which the auditor used to list these sales in the 1985 test period shows 38 companies to whom petitioner made contractual sales. Most made multiple purchases from petitioner with many making large numbers of purchases. The following companies used petitioner's services the most: A--- S--- C--- (19), D--- Ind. (85), K--- C--- (45), E--- L&C (90), I--- (78), H--- C--- (58), P--- Inc. (31), R--- S--- Inc. (131), and T--- C--- & G--- (20). Most of the sales prices charged by petitioner for the quantity of each product destined for each consumer were below $225. Some were larger, including six over $1,000 ($1,034; $1,158; $1,375; $1,592; $2,750 and $2,864).

Ms. Kelly and Mr. Highland said that the auditor found that petitioner had hired and paid the common carriers to deliver the goods to the California consumers.

Mr. V--- described the operations as follows: Petitioner made only sales for resale. Petitioner sold primarily to the same small group of companies who made many repeat purchases. Petitioner and each company initially agreed that petitioner would manufacture a specific solution; place it in containers; prepare a label containing the name of that particular company, the ingredients, etc.; place the labels on the containers; and place the containers on pallets to await shipment. The companies directed petitioner to furnish the goods to a carrier hired by the companies. Petitioner made no deliveries of goods. Petitioner's employees merely used forklifts at its --- --- plant to place pallets of goods onto the trucks of the carriers. The carriers delivered the products to the consumers. Petitioner's sales were F.O.B. plant. Petitioner subsequently billed the companies for the products sold, and a $3.00 service charge for hazardous goods to be shipped by UPS. The companies paid petitioner. The companies billed and received payment from the consumers. Petitioner does not know the exact amount of the prices charged by the companies, but estimates it to be as high as four or five times their cost. The companies paid the carriers. Petitioner did not pay any carriers.

Mr. V--- also represented that petitioner only made sales in the fashion described in the prior paragraph. He said that petitioner had no customers who were consumers. According to him, petitioner made no sales of products under petitioner's name. He indicated that it acted to manufacture, bottle, label, and provide products to carriers only upon explicit directions from the companies. He said that the companies expressly directed petitioner what solutions to manufacture, what labels to use, etc.

Analysis and Conclusions

Revenue and Taxation Code section 6007 reads as follows:

> "A 'retail sale' or 'sale at retail' means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property.
>
> "The delivery in this State of tangible personal property by an owner or former owner thereof or by a factor, or agent of such owner, former owner or factor, if the delivery is to a consumer or person for redelivery to a consumer, pursuant to a

> retail sale made by a retailer not engaged in business in this State is a retail sale in this State by the person making the delivery. He shall include the retail selling price of the property in his gross receipts."

Each company which made a contractual purchase from petitioner must have been a retailer not engaged in business in this state in order for petitioner to be liable under section 6007 on the basis of making a "delivery" type of sale to consumers in California.

The phrase "retailer not engaged in business in this state" is not defined in section 6007or any other section in the Sales and Use Tax Law. The Board has previously, however, used the definition of the converse phrase "retailer engaged in business in this state" from section 6203 as defined for purposes of the use tax collection duty of retailers on sales for use in California which are not subject to sales tax (see Business Taxes Law Guide annotation 495.0790 [8/19/80]). The pertinent part of section 6203 reads as follows:

> "'Retailer engaged in business in this state' as used in this and preceding section means and includes any of the following:
>
> "(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."

Although section 6203 expressly provides that the phrase "retailer engaged in business in this state: is defined for purposes of sections 6202 and 6203 which implies that the definition is limited to the use of that phrase in those two sections, the dame theory is involved in the second paragraph of section 6007 and in sections 6202/6203. If an out-of-state person is a retailer which is also engaged in business in California, then the Board can impose a tax or tax collection and remittance debt on that person, and there would be no need or right to impose liability upon the middleman under the second paragraph of section 6007. If the out-of-state person is not engaged in business in California, then the Board cannot impose a tax or tax collection and remittance debt against that person, but can hold the middleman liable under the second paragraph of section 6007. Thus, we believe that using that definition in section 6203 for what is a retailer engaged in business in this state is appropriate for finding who is a retailer not engaged in business in this state under section 6007.

The available evidence establishes that <u>some</u> of the companies were retailers who were engaged in business in this state at the times of these multiple step transactions even though the companies were not registered with the Board. Petitioner, and thus its place of business in

California, were used by some of these companies as an agent/representative and place of business/distribution for purposes of distributing and delivering the goods to the carriers for shipment to the California consumers. Petitioner was not listed on the bills of lading as the person from whom the goods were received by the carrier, or for any other reason. The out-of-state company was listed thereon as delivering the goods to the carrier. Those carriers were hired and paid by the companies, not by petitioner. The carriers prepared the bills of lading based solely upon instructions from the companies. This evidence supports Mr. V---' statements and shows that petitioner's charges for "UPS freight charges" were not charges for actual freight. It was consideration for the product, but billed via a misleading label. Furthermore, the unique relationship between petitioner and each company involved far more than a mere typical supplier-purchaser relationship. The companies used petitioner in their manufacturing processes which resulted in them controlling most of what petitioner did. Petitioner was specifically directed how and when to manufacture, bottle, label, and prepare the goods for shipment. Petitioner did not make retail sales of any of its products to any of its consumers. It did not offer sales of anything to the public. It made no sales of products in its own name. It apparently acted independently, but voluntarily restricted its operations to be in this unique manner. Such companies regularly, repeatedly, and continuously used petitioner as their person (and place) in California for distribution and commencement of delivery of products to their own customers, the consumers. These were established relationships and courses of dealing.

This situation is far more than the one or occasional/infrequent delivery situations which appear to be intended by the Legislature to be covered under section 6007 (see the Board's Legal Staff interpretation on this subject in annotation 495.0790; see also the "occasional" versus "regular" delivery analysis in Miller Bros. Co. v. Maryland, 370 U.S. 340, 98 L.Ed. 744, 74 S.Ct. 535 (1954), regarding the subject of nexus for a state seeking to impose a use tax collection duty and debt upon an out-of-state retailer). Petitioner has submitted satisfactory evidence of the details of its relationship with these companies and the regularity with which the companies used petitioner as agent/representative, sufficient to overcome any alleged "assumption" set forth in annotation 495.0790 that the companies were not engaged in business in California. Also, these companies derived significant income from these California sales since they imposed such large markups on their price paid to petitioner. The out-of-state companies which were principals were engaged in business in California and incurred California sales tax liability on their gross receipts derived from these California retail sales. Petitioner is thus not liable under section 6007 as to gross receipts or retail selling prices in transactions involving those particular companies (see discussion, infra). Petitioner's sales to those companies were all for resale excluded from sales tax (see Regulation 1668(c), first sentence). The auditor was incorrect in apparently merely relying upon the alleged assumption in annotation 495.0790 because these companies were not "registered" with the Board. The auditor ignored the above-mentioned facts which evidence that some of the companies were retailers engaged in business in this state.

Petitioner is liable under section 6007 measured by the "retail selling price" in transactions involving the remaining companies which were not engaged in business in this state. In light of Mr. V---' statements that the companies charge consumers four to five times its cost,

the auditor's use of only a 100 percent markup on petitioner's actual gross receipts appears very reasonable.

It appears that in order to best ascertain which companies which were engaged in business in this state and those who were not is to have an auditor examine petitioner's records for the other two years in this audit to identify the activities of each company over a three-year period. The following companies are found by us to have been retailers engaged in business in this state during 1985 based upon the frequency of sales as shown in Schedule 12A-1: A--- S--- C---, D--- Ind., K--- C---, E--- L&C, I---, H--- C---, P--- Inc., R--- S--- Inc., and T--- C--- & G---. Whether or not these companies were also engaged in business in this state in 1983 and 1984 depends upon the actual facts. If the frequency of activity in 1983 and/or 1984 is similar to 1985, they were such retailers in 1983 and/or 1984. As to the remaining companies, we need to examine the 1983 and 1984 activities in detail to make a recommendation for those years and for 1985.

Recommendation

Reaudit as recommended herein.

_____ 10-16-90

Stephen A Ryan, Hearing Officer Date