STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
APPEALS REVIEW SECTION (MIC:85)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-5550

July 30, 1993

REDACTED TEXT

Gentlemen:

Re: REDACTED TEXT

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the Board staff perform a reaudit in accordance with the views expressed in the Decision and Recommendation. No action is required of you at this time, except that you are requested to cooperate with the audit staff during the course of the reaudit.

The audit staff will provide you with a copy of the reaudit report. A copy of that report will also be sent to me. At that time, I will write to you informing you of your options for appeal in the event that you disagree with the reaudit results.

Sincerely,

David H. Levine
Senior Staff Counsel

DHL:ljt
Enclosure
REDACTED TEXT.udl
cc: REDACTED TEXT

Mrs. Mary Ann Stumpf (MIC:81)
Business Taxes Appeals Analyst
Board Proceedings Division (w/enclosure)

Mr. Glenn Bystrom (MIC:49)
Principal Tax Auditor (file attached)

Out-of-State – District Administrator (w/enclosure)

STATE OF CALIFORNIA

220.0248

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
REDACTED TEXT	)	No. REDACTED TEXT
Petitioner	)	

The Appeals Conference in the above-referenced matter was held by Senior Staff Counsel David H. Levine on April 20, 1993 in Sacramento, California.

Appearing for Petitioner:	REDACTED TEXT REDACTED TEXT
Appearing for the Sales and Use Tax Department	Jack Warner District Principal Auditor

Protested Item

The protested tax liability for the period January 1, 1984 through December 31, 1991 is based on an estimate by the Sales and Use Tax Department (Department) of petitioner's unreported sales into California and is measured by:

State, Local and County	EQRF	Total Transit	STTI
$11,200,000	$1,516,667	$8,348,480	$641,665

A ten percent failure to file returns penalty has also been added.

Petitioner's Contentions

Petitioner contends that it had no nexus in the State of California and is therefore not required to collect use tax with respect to its sales of tangible personal property into California. Petitioner also contends that the measure of tax asserted by the Department is excessive.

Summary

The information regarding petitioner's business set forth herein is based on information provided during the Appeals conference, a brief filed by petitioner, an affidavit of Vice President of Finance REDACTED TEXT, and documents provided by schools or used for telephone contact during the audit period. Some of these documents are attached hereto as exhibits: Exhibit A consists of scripts used for telephone contacts: Exhibit B is a sample cover letter; Exhibit C is a confirmation letter; Exhibit D consists of instructions to participating schools; Exhibit E consists of instructions to homeroom teachers; Exhibit F is a letter to parents; Exhibit G is a form for teachers to order "appreciation" shirts; Exhibit H is a Student Order form; Exhibit I is a school Master Order form for Spring 1990; Exhibit J is the School Master Order form for Fall 1990; and Exhibit K is the Master Order instructions.

Petitioner is a corporation that is a screen printer producing clothing and other items imprinted with school names, mascots, colors, and logos. These items were sold during the audit period through programs which petitioner calls "Spirit and Pride" programs (to enhance the spirit and pride at each participating school). The items sold during these programs were imprinted with specific information pertaining to each participating school. Petitioner explains that it contacted school principals by telephone followed by documentation sent by mail. If a principal was interested in the program, the principal signed a form letter acknowledging that interest. (Exhibit C.) That letter included the statement:

> "If we are delighted with the quality of our free samples, we do agree to display them for one week and distribute take home slips to students, faculty, and parents through our homerooms."

After the principal returned this letter, petitioner sent additional material to the principal, consisting of sales brochures, order forms, and other marketing information. The principal in turn distributed documents to the teachers, who then distributed certain of the documents to the students. Among these was a form that the students were to deliver to their parents to complete to indicate whether they would participate in the program. (Exhibit F.) One of the forms given to teachers, Exhibit E, explains the reason for sending the parent letter home:

> "Pass out the Student Take-Home Slips and ask that they be returned signed Yes of No by a parent. It is your only assurance that they reached the home. To thank you for your help we want you to choose an *Appreciation Crew Shirt* in return for getting

> twenty or more take-home slips signed by a parent. (If you have less than twenty students you may qualify for a free shirt with $125 in total classroom sales.) Limit one free shirt, please."

Petitioner specified retail selling prices. However, petitioner states that the only relevant pricing requirement was that the school was required to remit to petitioner the "wholesale price" for the items and that the school was entitled to charge the stated retail price and keep the difference, or could have charged more than that price (and kept the difference), or could have merely charged the wholesale price and not make any profits from this activity. Petitioner provided separate order forms for teachers which reflected as the price the amount to be paid to petitioner (that is, using petitioner's terminology, the teachers paid the wholesale price and the school did not receive a profit from such sales. Petitioner states that the school was responsible for implementing the sales and that it did not dictate or require any type of distribution system or teacher participation nor did it communicate directly with teachers regarding the implementation of the sales.

Payment could be by cash, check, credit cards, or through petitioner's lay-away program. The students filled out and returned the order forms and, when payment was by cash or check, that payment was also given to the teachers. If payment was by credit card, petitioner called to verify them, and there was no financial obligation to the school. (Exhibit A.) Under the lay-away program, the parents paid $5.00 down and made the remaining payments to petitioner over four months using coupon books sent to the parents by petitioner. (Id.) After the students returned their individual order forms, the principal completed the master order form and forwarded that form, each individual student order form, and payment (less credit card amounts and lay-away amounts) to petitioner. Petitioner then packed each student's order individually and boxed the orders to group them by homeroom for easy distribution by the teachers.

During 1990 and 1991, petitioner conducted a "School Pride Awards" program. The School Master Order form included a listing of 3 categories of awards: "A" awards were a camcorder and a fax machine; "B" awards were a video cassette recorder and a color television; and "C" awards were a microwave oven and a small refrigerator. The minimum amount of sales for a "C" award was $500, with choices ranging up to a choice of 4 "B" or "C" awards with sales between $4,000 and $4,999 and a choice of one "A" award with sales over $5,000. (See Exhibit I.)

The Department asserts that the petitioner is the retailer of the tangible personal property sold to the students and cites in support of its position the case of *Scholastic Book Clubs v. State Board of Equalization* (1989) 207 Cal.App.3d 734.

Petitioner notes that a retailer must have nexus with a state before that state can impose a duty on that retailer to collect the state's use tax from the retailer's purchasers. (*Quill Corp.* v. *North Dakota* (1992) 112 S. Ct. 1904, 119 L.ed.2d 91.) Petitioner contends that *Scholastic Book Clubs* is distinguishable because in that case the seller sold books to students through teachers and that each teacher acted independently with no involvement with the school as a whole. Petitioner asserts that unlike that case, the principals here did not act under its

authority but acted on behalf of their schools. Petitioner states that the principals did not seek to promote their own or petitioner's goals but instead sought to promote the school's goals.

Petitioner also asserts that, even if it were required to collect the use tax in question, the Department has overstated the applicable measure of tax. Since petitioner believed that it did not have the requisite nexus with California, it refused to furnish any records for an audit by the Department. The Department's audit was therefore based on an estimated measure of tax derived from the information available to it. Rather than the $11,200,000 measure derived from that audit and asserted by the Department, petitioner contends that the correct measure is approximately $5,600,000. During the Appeals conference, petitioner indicated that if it did not prevail on the legal issue (nexus), it would makes its records available to the Department for a reaudit and the Department stated its willingness to conduct such a reaudit.

Analysis and Conclusions

There is no doubt that under *Quill*, the department cannot impose upon petitioner the duty to collect use tax from its purchasers unless it has a physical presence in this state. The Department has not argued otherwise. Petitioner asserts that it has no stores, offices, inventories, or employees in California. The Department has neither produced evidence nor argued otherwise. The Department instead relies solely on the relationship between petitioner and the participating schools in California.

If the school, the principal, or the teachers (or any combination thereof) had acted as representative, agent, or solicitor of petitioner for purposes of selling, delivering, or taking orders for the sales in question, then petitioner is defined by subdivision (b) of Revenue and Taxation Code section 6203 as a retailer engaged in business in California and was required to collect use tax from its purchasers who purchased property for use in California. This result would be constitutional under *Quill* because the California representative, agent, or solicitor would be the required physical presence in California. (See, generally, *Scripto v. Carson* (1960) 362 U.S. 207.) If the school, the principal, or the teachers were not the representative, agent, or solicitor of petitioner for purposes of making the sales in question, then petitioner would not be regarded as having the required physical presence in California and could therefore not be required to collect the use tax from its California purchasers. Furthermore, petitioner would not be defined as a retailer engaged in business in California under section 6203. Thus, the sole question to be answered herein is whether there existed an agency relationship within the meaning of *Scholastic Book Clubs* or whether there otherwise existed a relationship of representative, agent, or solicitor.

In that case, Scholastic Book Clubs had no physical facility, bank account, or regular employees in California. It conducted its business by distributing catalogs by mail to teachers and librarians in elementary and high schools. If it did not know the name of the teacher, it sent the catalog to, for example, "Third Grade Teacher." Each catalog included about 30 offer sheets. Teachers were under no obligation to distribute the offer sheets to their students (an average response rate to the catalogs was 14.6 percent).

Teachers who elected to do so distributed the offer sheets to their students, and the students made their selections and paid the teachers for the selected items. Some of the teachers had all checks made out to them and wrote a single check to Scholastic Book Clubs. Some teachers had parents make out checks directly to Scholastic Book Clubs. In any event, the teacher consolidated the orders and payments received and submitted full payment, which would consist either of a single check (written on the teacher's own account or the school's account) or the checks from the parents plus any required additional payment in a check drawn on the teacher's or school's account. The orders were then filled and sent from Scholastic Book Clubs' Missouri warehouse to the teacher placing the order, who then distributed the materials to the students who ordered them.

Scholastic Book Clubs also had a premium program to encourage teachers to place orders. They were given bonus points based on the size of their orders, which they could use to obtain merchandise from a gift catalog. The items selected from the gift catalog could be used for classroom or personal use.

The Court in *Scholastic Book Clubs* reviewed the relevant United States Supreme Court cases of *Miller Bros. Co. v. Maryland* (1954) 347 U.S. 340, *Scripto v. Carson* (1960) 362 U.S. 207, and *Nat. Bellas Hess v. Dept. of Revenue* (1967) 386 U.S. 753 and stated:

> "The instant case is more analogous to *Scripto* than to *National Bellas*. Although the teachers herein do not have written agency agreements with appellant, they serve the same function as did the Florida jobbers in *Scripto*- -obtaining sales within California from local customers for a foreign corporation. In fact, they do more. Unlike the Florida jobbers, the California teachers collect payment from the purchasers, and receive and distribute the merchandise. Appellant not only relies, but in fact depends on the teachers to act as its conduit to the students. Moreover, there is an implied contract between appellant and the teachers- - appellant rewards them with the bonus points for merchandise if they obtain and process the orders. The bonus points are similar to the Florida jobbers' commissions in *Scripto*; the more sales the teachers make, the more bonus points they earn.
>
> "Appellant minimized the payment of the bonus points, claiming the teachers and librarians do not and cannot earn their living by facilitating the sales for appellant, unlike the jobbers in *Scripto*. However, neither the form of the remuneration, the amount thereof, nor the fact that the teachers and librarians were not formally employed by, or dependent upon appellant for their primary income has any legal significance in determining whether they acted as appellant's representatives in soliciting orders for appellant's products in California. Further, unlike the Illinois customers in *National Bellas*, the students here are not solicited

> directly through the mail. The only way a student can order books is through a local intermediary- -his or her teacher. Appellant is thus exploiting or enjoying the benefit of California's schools and employees to obtain sales." (207 Cal.App.3d 739-40.)

In the present case, one of petitioner's arguments is that it dealt with the principals, and did not deal directly with the teachers. This is a distinction without a difference. If any person acted as petitioner's representative, agent, or solicitor in California for purposes of making sales, then petitioner is a retailer engaged in business in California. (Rev. & Tax. Code § 6203.) Here, that representative, agent, or solicitor could have been the principal, the teachers, the school, or any combination thereof. For petitioner to prevail, I must conclude that none of these persons acted as petitioner's representative, agent, or solicitor.

Petitioner asserts that the "Spirit and Pride" program was a school wide effort, orchestrated and managed by the principals, and that the principals did not seek to promote their own or petitioner's goals but rather to promote the schools' goals of fundraising and school spirit. Petitioner further asserts that the principals did not act under its authority but rather acted on behalf of their schools. In *Scholastic Book Clubs*, the teacher certainly did not have a *primary* goal of promoting the goals of Scholastic Book Clubs, but rather to make the materials available to students and to earn prizes.

I have no doubt that the principals here sought to promote the schools' goals and did not have the *primary* intent of promoting petitioner's goals. However, such a conclusion does not support petitioner's assertion that no agency relationship existed.[1] Rather, this assertion supports the conclusion that, if there was an agency relationship in this case, it was the school which acted as the representative, agent, or solicitor, the principal acting on behalf of that school and committing it and its employees (including teachers) to so act. Furthermore, as the court in *Scholastic Book Clubs* explained, "authority" for purposes of an agency relationship means the lawful delegation of power by one person to another. (207 Cal.App.3d at 737.) As in *Scholastic Book Clubs*, petitioner must concede that the principals (or schools) acted with its permission, and derived the "power" or "authority" to solicit orders, collect payment, and distribute merchandise from petitioner.

[1] The present case is similar to many agency relationships where the agent's *primary* goal is to increase that agent's commission. Viewing the full spectrum of agency relationships, the primary goal of the agent runs the gamut from total self-interest to almost selfless furtherance of the principal's goals, the more common interest level lying somewhere in the middle. While an agent does have certain duties to his or her principal (the more limited the agency relationship the more limited those duties), whether an agency relationship exists is not ascertained by merely determining the level of the agent's self interest.

Petitioner asserts that the principals' goal was not to obtain sales within California from local customers for a foreign corporation. The principals were clearly attempting to obtain sales from students. The question to be answered is whether those sales were by the schools as the sellers or by petitioner as the seller through its representatives, agents, or solicitors the schools (or principals or teachers or combination thereof). Petitioner argues that, unlike *Scholastic Book Clubs*, the principals here received no personal gain. This is irrelevant. As asserted by petitioner, the principals acted on behalf of their schools, and the schools received benefits (profit and enhanced school spirit).

In *Scholastic Book Clubs*, the agent receives prizes based on the amount of sales. Here, the school received a commission (the difference between the "wholesale" price and the retail price)[2] and, at least during a portion of the audit period, also received prizes based on the amount of sales. Petitioner was at least as involved in the sales program as was Scholastic Book Clubs, and apparently more so, providing display units that it encouraged the school to put out on display. It provided an incentive to teachers to actively participate by giving them gifts if the teacher received sufficient responses to their surveys of the students' parents. As explained by petitioner to teachers, "[t]o thank you for your help we want you to choose [a gift] in return for getting twenty or more take-home slips signed by a parent." (Exhibit E.)[3]

Here, as in *Scholastic Book Clubs*, the teachers received and distributed the merchandise ordered by the students. Here, as in *Scholastic Book Clubs*, the purchasers did not pay petitioner directly, but rather through the teachers. (Here, from the teachers to the principals or other designated person, on to petitioner.) The one exception to this latter point was with respect to lay-aways and credit cards. In those cases, petitioner dealt directly with the purchasers or the credit card issuers. Rather than detracting from a finding of a relationship of agency, this

[2] Petitioner asserts that the school was free to set whatever price it wanted as long as it remitted to petitioner the wholesale price. However, petitioner provided suggested retail prices to the schools and has submitted no evidence showing the percentage, if any, of schools altering that retail selling price. In the absence of such evidence, my belief is that such an alteration would be rare. If that retail selling price had been regularly ignored, the schools setting a higher or lower price, that would be a factor in favor of petitioner. However, even is such were the case, it is unlikely that such fact would alter my conclusion in light of all the other factors discussed herein which support a finding of agency.

[3] This shows that, in fact, petitioner regarded the entire school as the person it was dealing with, and that it dealt with that person through its leader, the principal. Thus, this reinforces my conclusion that it was the schools which acted as petitioner's agents, and not simply the principals or the teachers.

exception reinforces it because it shows that petitioner is the person who was making the sale to the consumer and, when necessary, dealt with that purchaser directly for payment.

For the reasons stated above, the analysis of the court in *Scholastic Book Clubs* applies with equal force to the facts here. I conclude that the schools, through their principals and teachers, acted as petitioner's agents in California for purposes of making sales to California consumers. Certainly, at a minimum, the schools were the representatives of petitioner and acted with its permission to solicit sales on its behalf. Petitioner was therefore a retailer engaged in business in California required to collect use tax from its purchasers and remit that tax to the Board. (Rev. & Tax. Code § 6203.) This conclusion is constitutional under the applicable United States Supreme Court cases, cited above, because petitioner had a physical presence in California, its representative, agent, or solicitors, and therefore has the requisite nexus with this state.

The tax determined by the Department's audit is measured by the sales price of property sold by petitioner to California consumers as estimated by the Department using the best information available to it. Since petitioner has indicated its willingness to provide its records to the Department for a proper audit, I conclude that such a reaudit should be conducted.

Recommendation

I recommend that the Department conduct a reaudit of petitioner's records to ascertain the correct measure of tax for retail sales made by petitioner to California consumers. Petitioner's tax liability should then be redetermined in accordance with that reaudit.

July 26, 1993

David H. Levine, Date
Senior Staff Counsel