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Memorandum

To: Mr. Bruce A. Belshaw
Oakland – Auditing

Date: October 22, 1990

From: John L. Waid
Tax Counsel

Subject: REDACTED TEXT, Inc.

REDACTED TEXT

Your memorandum dated September 19, 1990 to the legal office has been referred to me for a response. You want to know if we concur with your conclusion that the “time of the transaction” at which the sale takes place according to the taxpayer’s membership rule is upon receipt by the taxpayer’s customers of delivered goods. If so, the taxpayer’s transportation charges, though separately stated, still form part of the measure of tax.

I. FACTUAL BACKGROUND

You set forth the factual context as follows:

“The taxpayer operates a chain of discount stores selling office supplies, office furniture and related items. Two types of memberships are available and non-members may make purchases with a 5% surcharge. A membership application is attached.

“During the course of our routine audit, we noted that the taxpayer makes deliveries via his own facilities. Transportation charges are separately stated on sale invoices and do not exceed the cost of transportation. Transportation charges for our audit period exceed \$1,500,000, about 80% of which are associated with phone order sales.

“Every member receives a copy of the conditions of Membership and Rules of Operation (reverse side of the application). Rules number X and Y under Purchasing Privileges, Guests, and Other Rules refer to title passage.

“Rule X makes it clear that for cash sales, title passes upon payment and therefore, any subsequent delivery charges would be exempt from tax.

“Phone orders typically are charge sales and in many cases also involve delivery by the taxpayer’s own facilities....”

You enclosed a blank Membership Application which set forth on the reverse the Conditions of Membership and Rules of Operation (hereinafter "the Agreement"). The two rules regarding title to merchandise are set forth below:

"X. Title to all merchandise passes to the member at the checkstand after merchandise has been checked out and paid for. Thereafter, the member bears the risk of loss for such merchandise, except for willful or negligent acts of the Office Club or its employees.

"Y. Title to all goods to be delivered to the customer shall pass at the time of transactions with the member bearing all risk of loss of such merchandise except for willful or negligent acts or failure to act on the part of REDACTED TEXT or its employees."

Certain facts are missing. You did not include any copies of invoices. I will thus assume that they do not contain any statements regarding title which would be considered to be proof of an explicit agreement regarding title. (See attached memorandum.) Also, you do not provide any information as to the usage of trade and course of dealing between REDACTED TEXT and its purchasers. I will assume that there is no particular understanding between REDACTED TEXT and its purchasers regarding passage of title.

II. OPINION

A. Taxation of Transportation Charges

Revenue and Taxation Code Section 6012 includes transportation charges in gross receipts subject to sales tax as follows:

"(c)(7) Separately stated charges for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, but the exclusion shall not exceed a reasonable charge for transportation by facilities of the retailer or the cost to the retailer of transportation by other than facilities of the retailer; provided, that if the transportation is by facilities of the retailer, or the property is sold for a delivered price, this exclusion shall be applicable solely with respect to transportation which occurs after the sale of the property is made to the purchaser."

California Code of Regulations, Title 18, Regulation 1628, implements Section 6012(c)(7). Regarding change of title, Regulation 1628 states, in part, as follows:

"(b)(3)(D) Other Sales. Unless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and place at which the retailer completes performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different time and place....

“When delivery of the property is by facilities of the retailer, title passes when the property is delivered to the purchaser at the destination unless there is an explicit written agreement executed prior to the delivery that title is to pass at some other time.”

B. Risk-of-Loss Analysis

Paragraph REDACTED TEXT of the Membership Rules states that risk of loss shifts to the purchaser at the “time of transaction” also. Are the rules regarding shifting of the risk of loss definite enough and so closely related to title as to render this clause an explicit statement regarding title?

At common law in California, as title went, so went risk of loss. (Francis H. Leggett & Co. v. City of Los Angeles (1965) 235 Cal.App.2d 752, 754 [45 Cal.Rptr. 562]; Puritas Coffee & Tea Co. v. L. DeMartini (1922) 56 Cal.App 628, 634 [206 P. 96]; Henderson v. E. Lauer & Sons (1919) 40 Cal.App.696, 698 [181 P.811.]) The Uniform Commercial Code (hereinafter U.C.C.), however, changed all that. Although our research has not located a California case which has ruled on the subject, the courts of the other states which have considered the relationship between passage-of-title and shift-of-risk-of-loss have ruled that the U.C.C. has divorced risk-of-loss from title. (Martin v. Melland’s, Inc. (N.D. 1979) 283 N.W.2d 76, 79.) “The location or status of the title is not a relevant consideration in determining which party must bear the loss of [the property].” (Schock v. Ronderos (N.D. 1986) 394 N.W.2d 697, 698; See, also, Russell v. Transamerica Ins. Co. (1982) 116 Mich.App. 93, _ [322 N.W.2d 178, 181] – “Risk of loss, then, does not necessarily follow title.”; White Mtr. Corp. v. Bronx-Westchester White Trucks, Inc. (N.Y. Sup. Ct. 1975) 18 UCC Rep. Serv. 382; Caudle v. Sherrard Mtr. Co. (Tex. Civ. App. 1975) 525 S.W.2d 238, 241.) Title, then, may pass independently of the shift in the risk of loss. Accordingly, we conclude that a statement regarding risk of loss is not also a statement regarding passage of title.

Under the U.C.C., the buyer acquires an insurable interest in the goods once they are identified to the contract at the time the contract is made. (Cal. U.C.C. § 2501(1)(a).) When shipment is not by carrier, the risk of loss passes to the buyer when he receives the goods where, as here, the seller is a merchant. This rule is subject to change by agreement of the parties. (Cal. U.C.C. § 2509(3) & (4).)

C. The REDACTED TEXT Agreement

The only California case which has ruled on the requirements of Regulation 1628 regarding title passage clauses is the unpublished opinion in American Pacific Concrete Co Inc. v. State Bd. of Equalization (Aug. 23, 1990), No. A045525. While an unpublished opinion cannot be cited as legal precedent (Rule 977, Cal. Rules of Court), it is useful for our analysis as an illustration of what the courts are thinking on the subject. In that case, plaintiff manufactured concrete pipe for use in construction contracts. Its contracts were structured to avoid sales tax on any transportation charges. Sometimes its own trucks were used to transport the pipe. The sales contracts variously provided that the sale was “F.O.B. plant,” or “F.O.B. trucks at plant with full freight to jobsite....”, and some referred to the transportation charges as being post-sale. The cost was the same, since the rates were controlled by the Public Utilities Commission. At trial, substantial evidence was

introduced showing that the buyer was obligated to pay for the pipe when it was loaded onto the truck at the plant and then assumed the risk of loss for damage in transit except for plaintiff's negligent handling. (*Ibid.*, slip op. At 2-3.) There was no clause explicitly providing for passage of title.

The court found that the parties' use of the term "F.O.B. [seller's] plant" and the usage of trade and course of previous conduct dealing were adequate to demonstrate that the parties intended that title pass prior to shipment, thus rendering the separately stated shipping charges nontaxable. (*Ibid.*, slip op. pp.6-7) In reaching this result, the Court noted that the requirement contained in Regulation 1628(b)(3)(D) that there be an explicit agreement regarding title was not put into the regulation until after the sales at issue therein took place and so refused to hold the taxpayer to that requirement. (*Ibid.*, slip op. at 9.)

The Court's comment indicates that the result could have been different had the requirement for the explicit statement existed at the time of the sales. It does not stand for the proposition that the use of terms such as "F.O.B.," a shipment term (See, Cal. U.C.C. § 2319(l)), is the equivalent of an explicit title statement.

The case at issue closely parallels American Pacific Pipe. Here, the charges are separately stated and do not exceed the reasonable cost. When risk of loss shifted, the buyer assumed the risk of all loss except the negligent acts of the seller or its employees. Unlike the previous case, there is a passage-of-title clause.

Although the Agreement must be interpreted as a whole (Civ. Code § 1641), the clauses regarding title contained in the Agreement suggest that the parties' intent regarding passage of title was different in over-the-counter transactions than in delivered transactions. Paragraph REDACTED TEXT of the Agreement is explicit: title passes at the checkstand when the merchandise is checked out and paid for. On the other hand, paragraph REDACTED TEXT, is highly ambiguous. Title passes at the "time of transaction." When is the "time of transaction?" At the time the order is placed? At the time payment is made? At delivery? The reference to the risk of loss passing at the time of the transaction is no help since, under the U.C.C., the risk of loss may shift at a different time than the passage of title absent an unambiguous agreement as to both matters. Due to the lack of shifting-of-risk-of-loss clauses, we conclude that the Agreement contains no explicit statement that title passes prior to delivery. Thus, we agree with your conclusion that the transportation charge is included in REDACTED TEXT's gross receipts subject to sales tax.

JLW:sr

bc: Oakland District Administrator