STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-00XX
TELEPHONE (916) 324-3828
FAX (916) 323-3387
www.boe.ca.gov

June 14, 2002

Mr. [K]
XXX --- ---., Ste. XXX
---, California XXXXX

Re: Bradley-Burns Uniform Local Sales and Use Tax Law
Sales Tax v. Use Tax

Dear Mr. [K]:

At our meeting with Assistant Chief Counsel Janice L. Thurston, Ms. [V] of [M], Ms. Sheila Sarem of the Board's Legislative Unit, and Mr. John A. Thiella, Chief Deputy to Board Member John Chiang, we discussed your position that a transaction which was subject to state use tax could still be subject to a sales tax enacted by a city and/or county under the Bradley-Burns Uniform Local Sales and Use Tax Law ("local tax") if there was participation in the transaction by a local office of the retailer, even if title to the property sold passed out-of-state. In support of your position, you cited Diebold v. State Board of Equalization (1959) 168 Cal.App.2d 628, Regulation 1628(b)(4), and the p1ace-of-sale rules for jet fuel enacted in AB 66. We understand that your position is in the context of situations where, pursuant to the contract of sale, tangible personal property is shipped into California and not the situation where the property is already here where the sales negotiations take place.

We note here that the state sales tax laws are incorporated into the Local Tax Law. (Rev. & Tax. Code §§ 7202(b) & 7203(a).) Thus, the local tax ordinances are subject to the same constraints to which the state is subject, plus they are subject to whatever limitations are provided in the state sales tax itself.

We disagree with your belief that a transaction subject to state use tax may also be subject to local sales tax. First, it appears you contend that a city would have the power to levy a sales tax over an out-of-state retailer in situations when the state itself would not. The United States Supreme Court has made it clear that whether a state may make an out-of-state retailer pay its sales tax is a matter of having jurisdiction over that retailer. That jurisdiction can only be obtained when the retailer has on-going in-state activities that are so associated with its out-of-state sales that the state can constitutionally require the out-of-state retailer to pay its sales tax. The best statement of the rule is found in American Oil Co. v. Neill (1965) 380 U.S. 451:

> "[The] cases have ... firmly established the doctrine that when a tax is imposed on a out-of-state vendor, 'nexus' between the taxing State and the taxpayer is the outstanding prerequisite on state power to tax. Consistent with this requirement there must be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' [Miller Bros. v. Maryland (1954) 347 U.S. 340, 344-345.] Granted that when a corporation, pursuant to permission given, enters a State and proceeds to do local business the 'link' is strong. In such instances there is a strong inference that it exists between the State and transactions which result in economic benefits obtained from a source within the State's territorial limits. The corporation can, however, exempt itself by a clear showing that there are no in-state activities connected with out-of-state sales. In such instances, the transactions are said to be 'disassociated from the local business,' [Norton Co., supra.], and therefore may not, consistent with due process, be taxed."

(380 U.S. at 458.) The level of nexus which the American Oil case discusses is, ,of course, different from the much lesser level of nexus necessary to require the out-of-state retailer to collect the use tax the in-state purchaser owes for its use, storage, or other consumption of the property after interstate transport is complete. (See, Quill Corp. v. North Dakota (1992) 504 U.S. 292; Southern Pacific Co. v. Gallagher (1939) 360 U.S. 167, 177; McGoldrick v. Berwind-White Mining Co. (1940) 309 U.S. 33.)

This constitutional rule underlies Regulation 1620(a). For sales tax to apply to sales of goods that are shipped in from out-of-state to a California purchaser, two criteria must be met: (1) there must be participation in the sales by a previously-established sales office of the retailer; and (2) the sale must take place in California.

Second, your position ignores the fact that a city's jurisdiction to levy a sales tax is less than that of the state. A city can tax a selling activity only when that activity occurs within its borders. (City of Pomona v. SBE (1959) 53 Ca1.2d 305.) This is true even when the goods themselves are never in the city. (Belridge Oil v. City of Los Angeles (1954) 42 Ca1.2d 823, 828-239; Reg. 1802(a)(3).) Thus, even when the state has jurisdiction to levy a sales tax on an in-state retailer, the city does not unless the selling activity takes place within that city. If the state does not have jurisdiction to levy a sales tax on the sale, neither does a city.

Third, your position also does not consider the nature of the sales tax. "[T]he state sales tax has been judicially construed as 'not a tax on the sale or because of the sale but ... an excise tax for the privilege of conducting a retail business measured by the gross receipts from sales.' (Livingston Rock & Gravel Co. v. De Salvo, 136 Cal.App.2d 156, 160 [288 P.2d 317].)" (Pomona, supra., 53 Ca1.2d at 309.) In other words, the fact that title may pass in a particular city does not give that city the power to tax the sale unless the retailer also exercises its privilege of selling within the city.

A location cannot be considered a place of sale of the retailer under Regulation 1802 unless it can be issued a seller's permit. (Rev. & Tax. Code §§ 6066 et seq.) Regulation 1699(a) requires that for a location to be issued a permit, the place must be one owned or controlled by the retailer at which clients customarily negotiate sales. A place where title passes thus does not qualify as a place of sale unless the sale is negotiated there.

The local tax tracks the state tax. If the state sales tax applies, so does local sales tax; if state use tax applies, so does local use tax. Your position that the local sales tax applies when state use tax applies, leads to absurd results. This becomes clear when analyzing the application of tax to transactions involving entities that are constitutionally or statutorily exempt from tax, such as insurance companies, Indian tribes, and unincorporated instrumentalities of the United States. Since sales tax is imposed on retailers, not purchasers, such entities do not pay sales tax when they sell tangible personal property (although they may be required to collect use tax from the purchaser under defined circumstances.) Since use tax is imposed on the purchaser, such entities do not pay use tax when, storing using or otherwise consuming tangible personal property in the state, e.g. when purchasing tangible personal property where title passed outside the state. For example, an insurance company that sells tangible personal property inside this state in not subject to sales tax, but is nevertheless required to collect use tax from the purchaser for the use of the property in this state. The use tax collected is appropriately allocated as local use tax. However, if a local sales tax were applied to that transaction as you suggest, no local sales tax could be collected and allocated since the incidence of the local tax (a sales tax) would be imposed on a tax-exempt entity. In other words, this Agency cannot collect any tax constituting a sales tax from a person that is statutorily exempt from tax. Sales by these entities would be subject to state and (possibly) district use tax, but not local tax. This cannot be the result the Legislature intended.

Fourth, you contend that AB 66 supports your argument. AB 66 was specifically based on state sales tax applying to the jet fuel sales that were the subject of the statute. (Rev. & Tax. Code §§ 7205(a) & (b)(2).) Since your argument is based on state use tax applying to the transaction, AB 66 is no help to you.

You also contend that Regulation 1628(b)(4) supports your position. To the contrary, Regulation 1628(b)(4) was intended to do and does the opposite. In 1971, former Tax Ruling 58, "Delivery Charges," was amended and renumbered as Regulation 1628, "Transportation Charges". Prior to that time, however, in 1965, a sentence was added to Ruling 58(d) to clarify when title transferred for the purpose of determining when transportation charges were included in gross receipts: "However, at no time will title transfer at a place where the goods are not physically located." This phrase was added to implement newly enacted provisions of section 6010.5 which provided, as you recognize, that a sale cannot occur at a place where the goods are not physically located. This section was enacted to remove any possible confusion between the Sales and Use Tax Law and the (then new) Uniform Commercial Code on this matter. (Annot. 495.0680 (9/1 0/65).) This passage set up an apparent conflict with section 7205 and former Tax Ruling 2202, re-promulgated as Regulation 1802 the previous year, which declared the "place of sale" for the purposes for allocating local tax revenue to be the place where the sale was negotiated and that it was immaterial that title to the goods sold passed

outside of the jurisdiction levying the local sales tax or that the property sold was never in that jurisdiction. (Reg. 1802(a)(3).) As a result, subdivision (b)(4) was inserted into the new regulation by taking the last sentence of Ruling 58(d) and adding the caveat that it did not displace the local tax place-of-sale rules for local tax allocation purposes. Subdivision (b)(4) does not, and cannot, displace the requirement that, for state sales tax to apply, the goods must be located within California at the time the sales take place.

Finally, Diebold does not support your argument that where the property is located at the time of the sale is not important. Diebold is a pre-UCC case, and the UCC specifically declares that unless the contract provides otherwise, the sales occur when the seller completes his responsibilities with regard to delivery. (Cal. U. Comm. Code § 2401(2); see, Rev. & Tax. Code § 6006(e).) The result would be the same under the UCC as it was in Diebold. There, the taxpayer's local office solicited the orders for the safes, another local office repaired them, and still another Diebold division actually delivered and installed the safes. In the contracts at issue, Diebold had specifically reserved both title and right of possession until after it was fully paid. (168 Cal.App.2d at 631-632 & 636; See, Reg. 1628(b)(3)(D).) As a result, the seller completed its performance with respect to delivery at the purchaser's location. All of that happened in California, so state sales tax applied even though the safes had been shipped in from out-of-state. (See Regulation 1620(a)(2)(A).) Thus, where the goods are located at the time the sale is made was just as important under former law as it is now.

In summary, your argument that a city may levy a sales tax when the state cannot is incorrect. First, if the state cannot constitutionally levy a sales tax, a city, whose power to levy such a tax is less than that of the state, certainly cannot. Second, since the sales tax is not on the sale itself, but on the retailer's exercise of its privilege of selling, the sales tax cannot apply in a location where only title transfer takes place. Third, the sales tax cannot be levied in a city where customers do not negotiate sales.

Sincerely,

John L. Waid
Senior Tax Counsel

JLW/er

cc: Ms. Janice L. Thurston, MIC:82