State of California

Board of Equalization
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M e m o r a n d u m

To: Mr. Robert L. Buntjer, Administrator
Return Analysis & Allocation Section (MIC:32)

Date: September 2, 2008

From Cary C. Huxsoll
Tax Counsel (MIC: 82)

Subject: **Allocation of Local Tax Based on Use – ---**
Assignment No. ---

This is in response to your memorandum, dated February 6, 2008, in which you request an opinion as to the proper allocation of local use tax for transactions involving the above referenced taxpayer.

In your memo, you state, in relevant part:

"We are requesting an opinion from the Legal Division as to the proper allocation of local tax on the sale of voting machines by the above referenced taxpayer. This request is based on the following factual information.

"**Background:**

"At the time of these transactions, Regulation 1802(d)(1) provided that when the order for the property is sent by the purchaser directly to the retailer at an out-of-state location and the property is shipped directly to the purchaser in this state from a point outside this state, the transaction is subject to the local use tax ordinance of the participating jurisdiction where the first functional use is made. Regulation 1802(c)(1) provided that . . . transactions totaling $500,000 or more . . . were to be reported directly to the participating jurisdiction where the first functional use is made. For transactions under $500,000, the local tax [was] allocated on Schedule B through the countywide pool where the property was delivered.

"--- (---) sold electronic voting machines and related supplies to the Registrar of [V]oters in --- County. --- reported local taxes of $104,397 for 3Q2003 and $102,832 for 2Q2004, a total of $207,229. These transactions were reported and allocated on Schedule B to the countywide pool of --- County. Local Revenue Allocation Unit (LRAU) staff questioned the local tax allocation to the [--]--- countywide pool on 12/13/03 (date of knowledge).

"Information obtained from the --- County of Registrar of Voters disclosed that 8,959 voting machines were purchased for use within ---e County for the upcoming elections. Prior to the elections, these machines were stored at a location within the City of --- (----). The --- County Registrar of Voters provided information on the number of voting machines in each of the local tax jurisdictions within the [C]ounty of --- which allowed LRAU to re-allocate the local taxes to the place of 'first functional use' within each jurisdiction of --- County. First functional use was considered to be the intended/designed use of the property as a voting machine.

"Subsequent to this reallocation, a local tax inquiry was filed by MBIA on behalf of the City of ---. The basis of this inquiry was that the local tax should be allocated to the City of --- because the voting machines were first delivered and stored in the city. As a result of this inquiry, the local tax adjustments made by LRAU were reversed by the Allocation Group and all of the local tax was reallocated to the City of --- on October 27, 2005. The basis for the reversal was that the taxpayer is not required to nor has the ability to track the equipment to the place of its ultimate use. Local tax was reallocated to the place of storage in --- (---).

"It is the contention of MBIA, representing the City of ---a, that the transactions in question are subject to the local use tax ordinance of the participating jurisdiction. They argued that the voting machines are shipped to the location in --- to be stored until elections are held. Therefore, because the voting machines are only used for one day, the storage of the machines constitutes the 'first functional use' of the property. Also, MBIA contends because the tax was paid at the time of shipment of the voting machines to the place of storage pending future determination of need/use, rather then when the machines were actually used at the polling locations. . .the storage warehouse [is] the place of 'first functional use.'

"In light of this, we would like to request a legal opinion to determine which the following alternative allocation methods should be used to allocate the local tax amount totaling $207,229 for periods 3Q2003 and 2Q2004.

"1) Should local taxes on the voting machines be allocated to the jurisdictions where the voting machines were put to 'first functional use' were . . . first used in an election? [O]r

"2) Should local taxes on the voting machines be allocated to the jurisdiction where the voting machines were initially delivered and stored prior to being used in an upcoming election? That is, [does] storage constitute [the] first functional use[?]

"3) With regard to future situations, should the allocation of local tax on tangible personal property where the transaction is $500,000 or more, and the initial place of delivery is for storage prior to first functional use be addressed on a case by case basis whereby:

a) Local tax is allocated to the place of storage, unless
b) An investigation of the transactions discloses the actual location of the place of first functional use."

It is our understanding that the transactions at issue are each over $500,000, the taxpayer is required to collect and remit use tax because it is an out-of-state retailer who is engaged in business in this state under subdivision (c) of Revenue and Taxation Code section 6203, and the transactions at issue are subject to use tax.

Legal Background

As you know, a retailer who makes sales of tangible personal property at retail in California must pay sales tax for the privilege of selling that property at retail in this state. (Rev. & Tax. Code, § 6051.) When sales tax does not apply, use tax applies to a purchaser's use of property purchased from a retailer for use in California. (Rev. & Tax. Code, §§ 6201, 6401.) Although the use tax is the liability of the purchaser, when a retailer is engaged in business in California, that retailer must collect the California use tax from its purchaser and remit it to the Board. (Rev. & Tax. Code, § 6203.)

The Bradley-Burns Uniform Local Sales and Use Tax Law (Local Tax Law) authorizes cities and counties to impose a local sales and use tax (local sales or use tax) by adopting a local ordinance under the terms of that law. (Rev. & Tax. Code, §§ 7202, 7203.) All counties and cities in this state have adopted such an ordinance. Under subdivision (a) of California Code of Regulations, title 18, section (Regulation or Reg.) 1803, in general, in any case in which state sales tax is applicable, the local sales tax is also applicable. Similarly, when a transaction is subject to the state use tax, it is generally subject to the local use tax. (See Reg. 1803, subd. (b).)

Regulation 1802, subdivision (d), provides that if the state use tax applies to the transaction, and therefore the local use tax is also applicable, the "local use tax ordinance of the jurisdiction where the property at issue is put to its *first functional use* applies to such use." (Emphasis added.) In other words, the local use tax must be reported to the jurisdiction where the property at issue is first functionally used. If the transaction is of $500,000 or more, the seller must report the tax directly to the jurisdiction "where first functional use is made." (Reg. 1802, subd. (d)(1).)

There is no definition of "functional use" in the Local Tax Law or its accompanying regulations. However, with respect to the state Sales and Use Tax Law, "functional use" is defined for several different purposes in certain Sales and Use Tax Regulations. Subdivision (b)(3) of Regulation 1620 discusses the first functional use of property for purposes of determining if property was purchased for use in this state and defines "functional use" as "use for the purposes for which the property was designed." Other definitions of functional use in the Sales and Use Tax Regulations emphasize the same basic concept that "functional use" is use of property for which the property is designed. (See, e.g., Reg. 1501.1, subd. (a)(6).) Furthermore,

we note that under certain regulations, specific uses of property are not considered "functional use" of the property. Under subdivision (a)(3)(D)2. of Regulation 1660, in determining whether an acquisition sales and leaseback is consummated within 90 days of the seller's/lessee's first functional use of the property, a period of storage after the purchase but before the first functional use is *not* used to calculate the 90 day period. In other words, for purposes of Regulation 1660, storage of tangible personal property is not functional use of the property. We therefore conclude that for purposes of subdivision (d)(1) of Regulation 1802, "functional use" of property is use for which the property is designed, and does not include storage of property. Thus, first functional use of property occurs the first time that property is used for the purposes for which it was designed. Accordingly, the jurisdiction of first functional use is the jurisdiction where the property is first used for the purposes for which it was designed.

Board of Equalization Publication 28, *Tax Information for City and County Officials*, discusses staff policy concerning application of subdivision (d) of Regulation 1802 and the use of Board Schedule F for the reporting of tax on use tax transactions of $500,000 or more. On page 9, Publication 28 states that the place of first functional use "generally is presumed to be the jurisdiction to which the goods are shipped." Our understanding of the rationale behind this policy is that a retailer is more easily able to ascertain where it shipped property than where its customer actually puts the property to its first functional use. Accordingly, Schedule F instructs retailers who are directly reporting use tax on a transaction of over $500,000 or more to report said tax to "the jurisdiction where the goods are delivered." Unlike retailers, purchasers may more easily ascertain where they put property to use. Therefore, purchasers who are required to directly report use tax are instructed on Schedule F to report tax based on the location where the property is "first functionally used." We understand that Board staff analyzes local tax returns to determine whether the jurisdiction to which a retailer reports the local use tax on Schedule F is the jurisdiction of first functional use.

Analysis

Voting machines are designed to gather votes in an election. Therefore, first functional use of the voting machines occurs when the voting machines are used in an election. It is irrelevant that the voting machines are only used for one day. Storage of the voting machines does not constitute functional use of the voting machines. It is not relevant that the machines were purchased months prior to the first election at which they were used, or that the local use tax was paid when the machines were delivered and then placed into storage. Regulation 1802, subdivision (d)(1), mandates that the local use tax on these purchases be reported to the jurisdiction where each machine was first used to gather votes in an election and not to any location to which a machine was delivered or where a machine was stored prior to such use.

While retailers are not required to track where and when a consumer actually uses property, subdivision (d)(1) of Regulation 1802 nonetheless requires that the local tax be reported to the jurisdiction of the property's first *functional use* in use tax transactions over $500,000. The instructions on Schedule F are merely for a retailer's convenience in reporting and remitting the local use tax and retailers are not penalized for misallocation of tax when

delivery location is not the jurisdiction of first functional use. The fact that the retailer in this case did not know the jurisdiction of first functional use and reported tax to a different jurisdiction does not change the fact that the first functional use for each voting machine occurred when that voting machine was first used to gather votes in an election.

In future situations that come within the purview of subdivision (d)(1) of Regulation 1802, retailers may continue to presume that the location of shipment is the location of first functional use. However, when Board staff determines that delivery is made to a storage location, or if other facts indicate that the ship-to location is not the place of first functional use, staff should review the transactions on a case by case basis to determine the actual location of first functional use. If the location of first functional use is different than the delivery or storage location, the tax should be reallocated to the location of first functional use absent any prohibition (e.g., the date of knowledge rules of Revenue and Taxation Code section 7209.)

Conclusion

The local use tax in this case should be allocated to the jurisdictions where the voting machines were first put to use in an election. The storage of the voting machines does not constitute functional use of the voting machines; therefore, no local use tax should be allocated to the storage location on that basis. Board staff's analysis of returns and individual transactions should continue to be conducted on a case by case basis.

We hope this information is helpful. If you have any further questions, please do not hesitate to call me at (916) 324-2641.

CCH:ef
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