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June 22, 1999

Mr. D--- B. F---  
Director, State Tax Consulting  
--- LLP  
XXX --- ---, Suite XXXX  
---, California XXXXX-XXXX

Re: Unidentified taxpayer

Dear Mr. F---:

This is in response to your letter dated June 2, 1999 regarding the application of Revenue and Taxation Code section 6203 to an out-of-state retailer. You describe the facts as follows (footnote omitted):

“A California retailer (‘Company A’) is engaged in business in California for sales and use tax purposes by virtue of having retail stores in California. Company A currently has a website which describes the company and its products. The Company A website also offers Company A’s merchandise for sale. Although Company A’s website does not have the capability of accepting orders on-line, customers may purchase Company A’s merchandise via fax or toll-free telephone number or [at] retail stores.

“Company B is a wholly owned subsidiary of Company A, and is located solely outside of California. Although a separate legal entity, Company B’s name will be ‘Company [A] Online Retail Store, Inc., a subsidiary of Company [A].’ Company B will market and sell Company A labeled merchandise through Company B’s website which will accept and process orders on-line. All property sold through the Company B website is owned solely by Company B, and will be shipped from an out-of-state warehouse owned or leased by Company B. Company B will first purchase this merchandise from either the manufacturer or Company A at a marked-up price in an arm’s length transaction. Company B will

not have any employees, independent contractors or agents in California. Company B will not maintain an office, warehouse or showroom in California, nor rent or lease property in California. All documentation (i.e., sales invoice, bills of lading, etc.) evidencing Company B's sales in this Company B website process will refer to Company B as 'Company [A] Online Retail Store, Inc., a subsidiary of Company [A].' It is possible that some customers may return merchandise purchased through the Company B website to Company A stores or directly to Company B via mail. It is also possible that the Company A stores may have brochures or other marketing tools in their stores which refer to the Company B website.

"Based on the facts described above, please provide an analysis as to the application of tax to the following scenarios:

*"Scenario 1*

"Company B's website is hosted on a third-party server located outside of California. Is Company B regarded as being engaged in business in California?

*"Scenario 2*

"Company B's website is hosted on a third-party server located inside of California. Is Company B regarded as being engaged in business in California?

*"Scenario 3*

"Company A's website contains a hyperlink to Company B's website. Company B's website is hosted on a server located outside of California. Is Company B regarded as being engaged in business in California?

*"Scenario 4*

"Company A's website contains a hyperlink to Company B's website and Company B's website is hosted on a server located inside of California. Is Company B regarded as being engaged in business in California?

*"Scenario 5*

"We believe that having all documentation (i.e., sales invoice, bills of lading, etc.) referencing Company B as 'Company [A] Online Retail Store, Inc., a subsidiary of Company [A],' is clear evidence that Company B is a separate legal entity. However, we would like to know if just referencing Company B as 'Company [A] Online Retail Store, Inc.' is similarly sufficient or is there some other standard that must be met?

*“Scenario 6*

“As discussed, customers may return merchandise ordered from Company B to Company A stores. Upon return title transfers to Company B and Company A will then return the merchandise to Company B’s out-of-state warehouse. Company B will either issue a credit or refund to the customer upon receipt of the merchandise from Company A. It is anticipated that Company A will be compensated for costs related to the acceptance and shipment of the returned merchandise. We would like to know if this relationship creates sufficient nexus for Company B to register for sales/use tax purposes.”

I assume for purposes of this opinion that we would agree with your statement of facts that Company B solely owns the property sold from its website and that such property is shipped from an out-of-state warehouse owned or leased by Company B. I further assume that the warehouse contains only the property of Company B and is staffed by persons who are employees of Company B. (If Company A has any involvement with the warehouse or shipment of the property to the California customers, that would raise a question as to the application of the second paragraph of Revenue and Taxation Code section 6007.)

You note that the use tax is imposed on the purchaser, but that a retailer engaged in business in California as defined by Revenue and Taxation Code section 6203 must collect that use tax from its California purchaser and remit the tax to the Board. You then state:

“Based on the scenarios presented above, it is our interpretation that Company B does not meet the provisions of Section 6203 (a) – (c) and (e). However, we are unsure of Section 6203 (d). As stated previously, Company B will not otherwise have any employees, independent contractors or agents in California, nor will Company B maintain an office, warehouse or showroom in California or rent or lease property in California. All property sold by Company B to California consumers will be shipped from Company B’s out-of-state warehouse. We believe that Company B has not established sufficient substantial nexus with California to be required to collect the use tax notwithstanding that a related entity is engaged in business and operating in California as described above. In addition, we do not believe that the incidental acceptance by Company A of returned Company B merchandise establishes sufficient nexus with California to require Company B to collect the use tax.”

Initially, I note that you do not indicate the reason you are unsure regarding subdivision (d) of section 6203. Subdivision (d) is an *exclusion* from the definition of engaged in business in this state for certain activities through a computer telecommunication network located in this state, so a retailer would not be defined as engaged in business under subdivision (d). Subdivision (a) of Regulation 1684 essentially explains that the use of a web page on a third-party server is not a basis for regarding a retailer as engaged in business in this state, even if the

web page is on a third-party server located in this state. Thus, Company B's use of a web page on a third-party server for making its sales is not a factor in determining whether it comes within section 6203.<sup>1</sup>

In scenarios 1 and 2, you discuss the location of the third-party server that hosts Company B's website. As noted above, Company B would not come within section 6203 based on the location of that third-party server, whether it is inside or outside California, as long as no person involved in processing orders placed on Company B's website is located in California. In scenarios 3 and 4, you discuss hyperlinks on Company A's website to Company B's website. Again, regardless of the locations of the third-party servers on which the web pages are hosted, the inclusion of these hyperlinks would not bring Company B within section 6203.

In scenario 5, you ask how Company B must be distinguished from Company A in the specified documentation. Depending on the facts, the manner in which each company is identified to customers may indicate that the two companies are not truly separate entities or that one of the entities is acting as the representative of the other. In this regard, the current reference to Company B as Company A's subsidiary is certainly a more clear identification of their relationship as separate entities than a reference to just "Company A Online Retail Store, Inc." Nevertheless, I would not expect the facts to be such that the latter reference would be fatal to the contention that Company B does not come within section 6203.

In scenario 6, you explain that Company B's customers may return merchandise purchased from Company B to Company A's stores in California. Unless the entities are not regarded as truly separate entities, Company B will be regarded as engaged in business in this state based only on its own activities in this state, and those performed on its behalf. My understanding is that Company B will have no business location in California within the meaning of subdivision (c)(1) of section 6203. Accordingly, subdivision (c)(2) is the relevant provision in determining whether Company B is engaged in business in this state. It defines engaged in business in this state to include:

"Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property."

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<sup>1</sup> The location of persons processing orders placed on-line is relevant to whether a retailer comes within section 6203. I assume that no person involved in processing orders placed on Company B's website is located in California.

As relevant here, the question is whether Company A is acting as Company B's representative in this state for an activity coming within this provision. We do not agree that what you describe is merely an "incidental acceptance by Company A of returned Company B merchandise." While the return policies of retailers varies, as you are well aware, the return of products by purchasers is an integral part of a retailer's selling activity. The easier it is for a customer to make a return, the more likely that the customer will place the order in the first place. This is the very reason that the concept of "satisfaction guaranteed or your money back" is an important aspect of many retailers' marketing strategies.

The ability of Company B's customers to return unwanted items to local stores of Company A on Company B's behalf as an alternative to packing them up and shipping them back to Company B significantly enhances the attractiveness of placing orders with Company B. Company A's activities on Company B's behalf in this state facilitate Company B's maintenance of its California market. This is certainly sufficient to sustain a finding of nexus under the United States Constitution. (See, e.g., *Standard Pressed Steel Co. v. Washington Rev. Dept.* (1975) 419 U.S. 560.) This is also sufficient to bring Company B within the definition of retailer engaged in business in this state under subdivision (c)(2) of section 6203: Company A is acting as Company B's representative in this state for acceptance of returns of items sold. In addition, it appears that Company A may be acting as Company B's representative in this state within the meaning of subdivision (c)(2) of section 6203 by using brochures and marketing tools in California to promote sales by Company B.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine  
Supervising Tax Counsel

DHL/cmm

cc: Mr. James E. Speed (MIC:43)  
Ms. Freda Orendt-Evans (MIC:92)  
Out-of-State District Administrator (OH)