STATE OF CALIFORNIA

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STATE BOARD OF EQUALIZATION
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Executive Director

July 30, 1999

Mr. A--- L. D---
General Counsel
I--- C---
XXX --- Road
Suite XXX
--- ---, --- XXXXX

Re: Use Tax Collection Requirements

Dear Mr. D---:

As you were advised by letter dated June 30, 1999, your letter of April 1, 1999 has been referred to the Legal Division for response. ICI makes sales of tangible personal property to California consumers, and ICI has representatives inside this state for purposes of maintaining its market in California. Nevertheless, you believe that ICI is not required to collect use tax from its California customers based on Revenue and Taxation Code section 6377. You state:

> "Enclosed with your October 2, 1998 correspondence, you included information which justified imposing on an out-of-state seller the responsibility of registering and collecting use tax on all taxable sales made to purchasers in the State of California. Upon review of this information, it is still our belief that ICI is exempt from the registration and collection requirements of the California Sales and Use Tax Law for the following reasons:
>
> "1. There does not exist a sufficient nexus between ICI and the State of California to confer upon the State of California jurisdiction to require collection of use tax on sales made by ICI to customers situated in the State of California; and
>
> "2. ICI is not a 'retailer engaged in business in this state' or a 'retailer' as defined in the California Sales and Use Tax Law.
>
> "Section 6203 of the California Revenue and Taxation Code ('Code') imposes on every retailer engaged in business in the State of California, which makes sales of tangible personal property for storage, use, or other consumption,

not exempted, responsible for collecting use tax from the purchaser on behalf of the State. Included in the Code are the following key definitions:

"1. A 'retailer engaged in business in this state' is '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 tangible personal property*.';

"2. A 'retailer' is broadly defined as 'Every seller who makes sales of *tangible personal property.'*

"3. 'Under the authority of the retailer': any retailer who utilizes independent commission agents or manufacturer's representatives to solicit orders and who forwards these orders to the retailer for acceptance.

"Most importantly, Section 6377 of the Code specifically excludes from the definition of 'tangible personal property' consumables with a normal useful life of less than one year.

"In addition, while the materials included with your correspondence accurately point out that the United States Supreme Court, in interpreting the Interstate Commerce Clause of the U.S. Constitution, has required a nexus between an out-of-state retailer and a state in order for the state to require the retailer to collect use tax on sales to customers in that state, the Court has refused to extend this power to the States when the only connection with customers in the State is by common carrier. (See *Montgomery Ward & Co., Incorporated v. State Board of Equalization,* 272 Cal.App.2d 728 and the cases cited therein), despite upholding the power of a State to impose liability upon an out-of-state seller to collect a local use tax in a variety of circumstances.

"ICI is in the business of manufacturing ceramic component parts which are used in a variety of high technology industries. All of its products, regardless of industry, are consumed within one year, and most often significantly quicker, nor does the business require installation or assembly operations. I--- C--- has one manufacturing and administrative facility, which is located in --- ---, ---, and does not operate any retail outlets or manufacturing operations in the State of California, nor does the Company employ any representatives or independent contractors, by any title, in the State of California for the purpose of selling, delivering, installing, assembling, or the taking of orders for tangible personal property.

"In our August 24, 1998 response to the questionnaire submitted by your office, we replied that a now-former employee, T--- K---, occasionally traveled to California to provide engineering support services for products already sold from our facility in --- ---, ---. While the effect of providing responsible product support at the customer's request may have resulted in increased sales, or more accurately continued sales, Mr. K--- did not solicit orders or forward orders to ICI for approval. Moreover, Mr. K--- did not, nor does the Company or any current --- --- employee, deliver the products of the Company to the State of California except by way of common carrier.

"Based on the foregoing, it is our opinion that ICI does not maintain sufficient contact with the State of California to confer upon the State the constitutional jurisdiction necessary to require ICI to register with this Board to collect use tax on taxable sales. Further, ICI does [sic] is not a 'retailer engaged in business in this state' or a 'retailer' as those terms are defined in the statute. Moreover, the products manufactured by ICI are not considered to be 'tangible personal property' under the statutory definition."

For purposes of the California Sales and Use Tax Law, "retailer" is defined to include "[e]very seller who makes any retail sale or sales of tangible personal property ...." (Rev. & Tax. Code § 6015.) Accordingly, since ICI is a seller who makes sales of tangible personal property at retail, it is a retailer for purposes of California's Sales and Use Tax Law.

You contend, however, that the tangible personal property ICI sells is not tangible personal property for purposes of the California Sales and Use Tax Law, and that ICI is therefore not a retailer of tangible personal property. You are mistaken. For purposes of the California Sales and Use Tax Law, "tangible personal property" is defined as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses." (Rev. & Tax. Code § 6016.) The ceramic component parts ICI sells certainly come within this definition. You, however, have overlooked this basic definition of tangible personal property and rely instead on a reference in Revenue and Taxation Code section 6377, which provides a *partial* exemption from sales and use tax in lieu of the taking of an investment tax credit for sales of certain property used in manufacturing by certain "new" businesses. While you cite subdivision (b)(10) of section 6377 for the proposition that tangible personal property does not include consumables with a useful life of less than one year, you overlook the opening phrase of subdivision (b) which states "for purposes of this section...."

When property comes within subdivision (b)(10) of section 6377, it is not eligible for the exemption, and its sale or use is fully subject to tax. That is, the sale or use of property can qualify for the partial exemption provided by section 6377 only if it *is* tangible personal property as defined for the narrow and specific purposes of that section. That an item is not tangible personal property for the limited purposes of section 6377 does not mean that it is not tangible personal property for purposes of the Sales and Use Tax Law. Rather, it just means that the sale of such item is not eligible for the partial exemption.[1] The items ICI sells are tangible personal property, and ICI is a retailer of tangible personal property for purposes of California's Sales and Use Tax Law.

You argue that ICI does not have the requisite nexus with California for this state to impose a use tax collection duty upon it. In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court clarified the reasoning and then upheld the bright line test it had previously enunciated in *National Bellas Hess, Inc. v. Department of Revenue of Illinois* (1967) 386 U.S. 753:

> "*Bellas Hess* ... created a safe harbor for vendors 'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.'" (*Quill*, *supra*, 504 U.S. 315.)

ICI's activities do not come within the *Quill* safe harbor because its contacts with California are not solely by common carrier or mail. Instead, it has a clear and distinct physical presence in this state through its presence for purposes of providing on-site support related to its sales of tangible personal property. A number of United States Supreme Court decisions make it clear that a physical presence in the taxing state, especially when that presence is related to the maintenance of the retailer's market in the taxing state, is sufficient to support the state's imposition of a use tax collection duty on the retailer. Furthermore, it is clear that the physical presence in the taxing state need not be through employees but can be through representatives. (See, e.g., *Scripto v. Carson* (1960) 362 U.S. 207.)

The case of *Standard Pressed Steel Co. v. State of Washington Department of Revenue* (1974) 419 U.S. 560 is particularly instructive. In that case, the out-of-state taxpayer had a single employee in the taxing state, and that employee worked out of his home and consulted with the taxpayer's customer. The employee took *no* orders. The taxpayer argued that imposition of the tax was not constitutional because the in-state activities were so thin and inconsequential. The Court phrased the question as "whether the state has given anything for which it can ask return," and stated

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[1] In previous correspondence from ICI's accountant, she argued that ICI's products are exempt under section 6377. Your contention that these items are not "tangible personal property" as that term is used by section 6377 is equivalent to a concession that their sales are *not* exempt under section 6377 since section 6377 defines "tangible personal property" for its purposes simply to define the sub-class of tangible personal property that will come within the exemption. If an item is not "tangible personal property" as that term is used in section 6377, the partial exemption cannot apply, even if all other requirements of the exemption are satisfied.

that "[w]e think the question in the context of the present case verges on the frivolous." (*Id.* at 562.) As the Court noted, the taxpayer's employee in the taxing state "made possible the realization and continuance of valuable contractual relations" between the taxpayer and its customer. (*Id.*) It is clear that the very same can be said about the physical presence of ICI's representative in this state. That presence is directly related to ICI's sales of tangible personal property to California consumers, and enables ICI to maintain or expand the market for its product in this state. Accordingly, California's imposition of a use tax collection duty upon ICI is entirely consistent with the United States Constitution and relevant Supreme Court opinions.

The final question is whether California has, in fact, imposed a use tax collection duty upon ICI. As you know, California's nexus provision is set forth in Revenue and Taxation Code section 6203, which provides that a retailer engaged in business in California must collect the applicable use tax from its California purchasers. As relevant here, a retailer is engaged in business in California if it has "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." A person does not have to accept actual orders to be regarded as present in California "for the purpose of selling." It is clear that the presence of ICI's representative in California is directly related to ICI's sales and continued market presence in this state. Accordingly, ICI is engaged in business in this state for purposes of section 6203.

ICI's purchasers who purchase its product for use prior to any resale of the product owe use tax on their purchases. Please note that all sales of property are presumed to be retail sales unless the retailer takes a timely and valid resale certificate in good faith. (Rev. & Tax. Code § 6241.) That is, unless you accept timely and valid resale certificates in good faith, your sales will be presumed to be subject to the use tax unless you overcome that presumption and establish that the property was actually purchased for resale. Enclosed for your information are copies of Regulation 1525 and 1668 which discuss relevant issues further. As a retailer engaged in business in this state, ICI must collect the applicable use tax from its purchasers and remit that tax to the Board. (Rev. & Tax. Code § 6203.) The tax ICI is required to collect constitutes a debt ICI owes to the state. (Rev. & Tax. Code § 6204.)

You note that ICI's customers have indicated to you that they have been paying "all applicable sales and use taxes on taxable sales." We seek to collect only the tax due, no more and no less. Thus, ICI will be given a credit against the debt ICI owes under section 6204 for any amounts that it establishes were already paid by its customers. However, since ICI can be given a credit only to the extent it can establish the actual payment of use tax to the Board by its customers, I am sure you understand why ICI does not want to be in the position of trying to make such a showing on a prospective basis. The only way ICI can protect itself from the risk of being unable to make a sufficient showing is to register with the Board, collect the applicable tax, and remit that tax to the Board itself.

If you have any questions about how tax applies to ICI's sales (e.g., when such sales are regarded as nontaxable sales for resale), please feel free to write again.

Sincerely,

David H. Levine
Supervising Tax Counsel

DHL/cmm
Enclosures

cc: --- --- District Administrator (---)