

M e m o r a n d u m**480.0025**

To: Mr. Randy Rose
Assistant to Board Member
Ernest J. Dronenburg, Jr.

Date: November 16, 1988

From: E. L. Sorensen, Jr.
Senior Tax Counsel

Subject: BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT

This is in response to your October 14, 1988 memorandum to Mr. Glenn Bystrom regarding this taxpayer. You relate in summary that BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT Vision Services, Inc. BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT contends that it is a buying group of member doctors for the purchase of ophthalmic supplies, that it is not a retailer of those supplies, and that it relied upon written advice from the Board in establishing its not-retailer status. You note that the Board's legal staff is of th opinion that this taxpayer is a retailer, and Mr. Bystrom agrees with our position. You would like to respond to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT with an explanation of the basis for our conclusion regarding its status as a retailer, since the taxpayer does not appear to transfer either possession or title to the products ordered by the doctors. You ask if we have concluded that BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT has the legal obligation to pay for the inventory ordered and shipped to doctors by the vendors, and if so, how we arrived at this conclusion.

By way of background, I note that it is common practice in many industries for retailers to accept orders from their customers and forward the orders on to manufacturers, with instructions that the manufacturer is to ship the property sold directly to the customer, not to the retailer. These types of transactions, referred to as drop shipments, are sales for resale from the manufacturer to the retailer and retail sales from the retailer to the customer, notwithstanding that the retailer never took possession of the property sold. (For example, see Business Taxes Law Guide Annotations 495.0900 and 495.0980.) The retailer obtains title to the property sold from the manufacturer and transfers title to the customer because there was no contractual agreement directly between the customer and the manufacturer regarding the sale of the property. The manufacturer issues an invoice to the retailer showing the property as sold to the retailer and shipped to the retailer's customer. As noted below, there are differences between this type of

transaction and BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT's transactions, but our opinion is that these differences do not alter the result.

I believe it will be helpful to review the facts concerning this taxpayer's transactions which indicate to us that it is the retailer of the ophthalmic supplies. First, it is our understanding that the taxpayer has oral agreements with vendors that it, and not its member doctors, will pay the vendors for the supplies ordered by the member doctors. It is also our understanding that the member doctors receive a list of vendors from BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT who have agreed to bill BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT at quantity discount prices for the supplies ordered by the doctors. The doctors cannot order supplies at the discount prices from vendors not on BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT's list. Nor can the doctors receive the discount prices from the approved vendors unless the billing and payment is handled by BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT. The vendors also receive from BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT a list of eligible member doctors whose orders will be paid for by BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT. There is a written agreement between BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and its member doctors which sets out the terms of payment by the doctors to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT. There is no indication that the doctors have any contractual liability for payment directly to the vendors. The fact that the contractual rights and obligations regarding payment flow through BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT by means of these separate agreements between BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and its member doctors and between BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and the vendors, indicate that BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT is purchasing the supplies for resale to the doctors, rather than merely acting as a billing service for purchases by the doctors from the vendors. A "sale" is defined by Revenue and Taxation Code Section 6006(a) as "[a]ny transfer of title or possession, ... in any manner or by any means whatsoever, of tangible personal property for a consideration." Under Revenue and Taxation Code Section 6007, a "retail sale" means "a sale for any purpose other than resale in the regular course of business in the form of tangible personal property." Here BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT pays a consideration to the vendors for its purchases, but itself makes no use of the ophthalmic supplies. Instead, the supplies are drop shipped to the member doctors who pay a consideration for their purchases not to the vendors but to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT.

Second, BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT specifically notes in its agreements with the doctors that it is not a bank or a loan institution. There is nothing in the agreements to indicate that BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT's payments to the vendors for the supplies ordered, are loans of the purchase price to the member doctors. In other words, BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT has not sought to structure the transactions as nontaxable financing arrangements.

Third, in their oral agreements with BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT, the vendors agree to sell the supplies at a volum discount price. However, no individual doctor orders enough to qualify for the discount; rather, it is the buying group as a whole which purchases the supplies in sufficient quantities to qualify for the vendor's discount. This fact indicates that it is not the individual doctors, but rather the buying group, which is purchasing the supplies from the vendors.

There are some facts which might tend to indicate that BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT is not a retailer. First, BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT in its agreement iwht the member doctors disclaims that it is a supplier (seller). However, it also disclaims that it is a lender. If it is neither a seller nor a lender, we cannot see on what basis it is paying for the supplies ordered by the doctors before receiving the payments for the supplies from the doctors themselves.

Second, some invoices from vendors recite not only that the supplies were delivered to a member doctor but also that these supplies were "sold to" that member doctor. Such an invoice would, on its face, indicate that the doctor was liable directly to the vendor for the price of the goods sold. However, apparently this is not actually the case, and these same invoices also state that the supplies are "billed through BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT". These invoices are at best conflicting evidence of whether there is a sale from the vendor directly to the doctor. But in view of the fact that there are oral agreements regarding payment between BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and the vendors, and no such agreements between the doctors and the vendors, our opinion remains that notwithstanding the "sold to [member doctor]" statements on the vendors' invoices, title actually passes from the vendors to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and from BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT to the doctors.

Third, the doctors place their orders directly with the vendors, not with BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT. We do not think this fact is enough to regard BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT as merely a billing service because BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT's arrangements still require that the member doctor be on an approved list and that the vendor also be on an approved list. The member doctor's listing is, in effect, an authorization from BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT to place orders directly, but it does not affect BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT's obligation to pay the vendor for the supplies.

Finally, BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT contends that it is treated as an unsecured creditor when a member doctor files for bankruptcy and BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT files a claim on the doctor's inventory of supplies ordered through BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT. Without additional facts, we cannot say whether this is the correct bankruptcy result. However, our view is that it is likely BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT would be considered to be a secured creditor of these supplies if

it issued resale certificates to the vendors, accepted invoices from the vendors which show that the supplies are sold to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT and, on its own invoices to its member doctors, collected sales tax reimbursement or use tax measured by the price charged by BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT to the member doctors.

I am not aware of what written advice the taxpayer received from the Board to establish non-retailer status. If there is such written advice to BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT, my recommendation is that we promptly inform BEGIN DELETED TEXT REDACTED TEXT END DELETED TEXT that the Board does regard it as a retailer for purposes of the Sales and Use Tax Law.

ELS:sr

cc: Mr. Glenn Bystrom