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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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March 23, 1995

Mr. G--- E---
Revenue Manager, City of --- ---
P.O. Box XXXX
--- ---, California XXXXX

RE: SZ --- XX-XXXXXX
Local Tax on Out-of-State Sales

Dear Mr. E---:

Senior Tax Auditor John Hadley of our Local Tax Section has asked the Legal Division to review your letter to him of November 28, 1994, responding to his letter to you dated October 31, 1994. These two letters followed up on previous correspondence between you, Newport Beach's local tax consultant [A], and the Local Tax Section regarding allocation of local tax revenues derived from this taxpayer's sales. As I understand it, the taxpayer is a retailer of [tangible personal property] with several sales offices in California, one of which is located in Newport Beach. There appears to be no dispute that the majority of sales at issue are negotiated at or with the participation of this sales office. The goods are shipped from the taxpayer's out-of-state inventory. The question, then, is which tax (sales or use) applies to these transactions. In reviewing the file, I note that, by cover letter dated July 11, 1994, you sent Mr. Hadley a copy of the taxpayer's "Sales Agreement for [tangible personal property]." This particular example is a copy of one executed between the taxpayer and Los Angeles County on July 1, 1992.

You contend that under this agreement and Regulations 1620 and 1802(a), title to the taxpayer's product passes in California, and the sales tax is the applicable tax with regard to the taxpayer's transactions. You once again aver that the Board's practice of allocating local tax revenues to countywide pools in certain instances is illegal. You also request reallocation of misallocated tax under Revenue and Taxation Code Section 7209.

OPINION

As to the issue of the legality of the pool allocation procedure, the courts have long since validated its use in the limited circumstances to which it applies. (City of San Joaquin v. S.B.E. (1970) 9 Cal.App.3d 365.) The Board formally approved its use by Resolution dated December 6, 1994. While we might differ over whether or not it applies in a particular factual situation, we may take the propriety of the concept as settled and move on.

Local tax follows the state tax. If the sales at issue are subject to state sales tax, they are subject to local sales tax; if subject to state use tax, then local use tax. It appears undisputed that the goods are shipped in from out of state and that the majority of sales are made through a local sales office. In order to determine the appropriate tax (sales or use) we turn, as was noted in your correspondence, to Regulation 1620. Subdivision (a)(2)(A) provides as follows:

> "Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any local branch, office, outlet or other place of business of the retailer in this state, or agent or representative operating out of or having any connection with, such local branch, office, outlet or other place of business and the sale occurs in this state." (Emphasis added.)

Regulation 1628(b)(3)(D) discusses where the sale takes place as follows:

> "Unless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and place at which the retailer completes his performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different time or place. If the contract requires or authorizes the retailer to send the property to the purchaser but does not require him to deliver it at destination, the retailer completes his performance with respect to the physical delivery of the property at the time and place of shipment, e.g., delivery of the property to a carrier for delivery by the carrier to the purchaser; but if the contract expressly requires delivery at destination, including cases where one of the terms of the contract is F.O.B. place of destination, the retailer completes his performance with respect to the physical delivery on tender to the purchaser there. When delivery of the property is by facilities of the retailer, title passes when the property is delivered to the purchaser at the destination unless there is an explicit written agreement executed prior to the delivery that title is to pass at some other time."

When property is shipped "F.O.B. Destination," and the carrier loses or damages the property, the seller still has no real control over it once it is in the hands of the carrier but nevertheless is obligated to make good on the loss. As you know, "sale" means and includes any transfer of title or possession in any manner or by any means whatsoever of tangible personal

property for a consideration. (Rev. & Tax. Code § 6006(a)). (Unless otherwise stated, all subsequent citations are to the Revenue and Taxation Code.) Unless otherwise agreed, title passes at the time and place when the seller completes his performance with respect to physical delivery of the property sold. (Cal. U. Comm. Code § 2401(2); Reg. 1628(b)(3)(D).) The place of sale for state sales and use tax purposes (See, Reg. 1628(b)(4)) is the place where the property is physically located at the time the seller completes his performance with respect to physical delivery of the product. (Rev. & Tax. Code § 6010.5; Annot. 495.0680.) Sales and Use Tax Annotations are excepts from previous Board staff opinion letters and serve as guides to staff positions. This rule is derived from California Uniform Commercial Code Section 2401(2). Subsection 2319 of that Code discusses the effect of an "F.O.B." term, in part, as follows:

> "(1) Unless otherwise agreed the term F.O.B. (which means 'free on board') at a named place, even though used only in connection with the stated price, is a delivery term under which
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> * * *
>
> "(b) When the term is F.O.B. place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this division (Section 2503)...."

California Uniform Commercial Code Section 2503 provides that "tender of delivery" is the seller's responsibility. These three statutes, reflected in Regulation 1628(b)(3)(D), provide rules of general application regarding the the place of sale of goods for the purpose of determining if state sales tax or state use tax applies.

As you noted in your letter, Paragraph 6.a. of the sample contract states as follows: "All deliveries will be F.O.B. destination." Under the above authority, then, we conclude that sales in which the contract contains this F.O.B. clause occur in this state, and the proper tax to be applied to such sales in which the local sales office also participated is the sales tax. (Reg. 1620(a)(2)(A).) As a result, local sales tax applies to these transactions. The local sales tax revenues derived therefrom should be allocated to the sales office where the principal negotiations took place--normally, where the order was made. (Reg. 1802(a)(2).)

The next question is whether or not local tax should be reallocated back three quarters from the date the Board received knowledge of facts causing and indicating the probability of an improper distribution. (§ 7209.) The issue in this matter all along has apparently not been the existence of a sales office in California participating in this sale, but where the sale actually took place (outside or inside this state). The first letter which supplies facts on this issue appears to be yours to Mr. Hadley of June 11, 1994, to which was attached a copy of the sales contract containing the F.O.B. clause at issue. We thus conclude that such date is the date of knowledge in this case. (See, Bus. Tax. Gen. Bull. 59-12.2.)

Section 7209 permits, but does not require, the Board to redistribute local tax revenues when it acquires facts indicating the probability of an improper distribution. Where the issue has involved the place of sale, the Board has consistently not reallocated tax back before the date of the determination as to the proper place of sale has been made. In this case, moreover, the issue has been the fundamental nature of the tax from which the revenues are derived. Until that issue is resolved, there cannot be said to be an improper distribution. As we understand it, not all of the taxpayer's sales contracts contain an "F.O.B. Destination" clause, and not all of those that do are negotiated with the participation of a local sales office. Thus, it would take a sale-by-sale analysis to determine which sales should have been allocated to the city in which the sales office was located, creating a huge administrative burden for the retailer. Finally, reallocation would be unfair in this case, because revenues arising in a quarter prior to the date the issue was even raised (apparently December 23, 1993) would be reallocated. We are of the opinion that, as the question as to the nature of the tax is only just now being resolved, reallocation under Section 7209 is not proper in this case. Local sales tax revenues derived from sales where the Newport Beach office participated in the sale and whose contracts contain an "F.O.B. Destination" clause should be allocated to Newport Beach beginning the Second Quarter 1995.

I am by copy of this letter notifying the Local Tax Section of our opinion in this matter. I hope the above discussion has answered your question. If you need anything further, please do not hesitate to write again.

Sincerely,

John L. Waid
Tax Counsel

JLW:sr

cc: Mr. Larry Micheli (MIC:27)
--- District Administrator
--- District Administrator
Mr. David H. Levine