220.0112

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

APPEALS UNIT

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: [redacted] Petitioner----	)	HEARING DECISION AND RECOMMENDATION

The above-referenced matter came on regularly for hearing before Hearing Officer Janice M. Fallman on September 11, 1990, in Ventura, California.

Appearing for Petitioner:	Appearing for the Department of Business Taxes:
	Harry P. Asuncion Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1981, through June 30, 1986, is measured by:

Item	State, Local and County
Disallowed ex-tax sales of repair parts billed to the customer, which were used in the overhaul of the customer-owned landing gear - actual basis. ($543,757 less $295,456 reaudit adjustment)	$ 248,301
Disallowed ex-tax sales of landing gear (sold under long- term landing gear exchange agreements) - actual basis. ($6,116,761 less $3,434,072 reaudit adjustment)	$ 2,682,689

Petitioner also contests a 10 percent penalty for failure to file returns for the period January 1, 1981 to March 31, 1986.

Petitioner's Contention

Petitioner was not engaged in business in the State of California and had insufficient nexus by which the State could impose upon it a duty to collect use tax.

Summary

Petitioner is a corporation which maintains its corporate offices in the REDACTED TEXT. It overhauls, repairs, and maintains landing gear on wide-bodied aircraft. It also sells landing gears and parts to consumers. Subsequent to this audit, petitioner obtained a permit from the Board and now collects California use tax for hydraulic landing gears and parts delivered in this State.

During the audited period in dispute, petitioner delivered numerous hydraulic landing gears and parts to its customers at major airports within the State of California. There they were substituted for landing gears and/or parts on aircraft located within the State of California. These deliveries were made pursuant to contracts negotiated by petitioner's home office in REDACTED TEXT. The contracts between petitioner and the various airlines and aircraft companies declared that delivery was FOB REDACTED TEXT. When many of these contracts were negotiated, petitioner contracted to provide scheduled maintenance and delivery of replacement parts but was unaware where and when performance of those contractual terms would occur. As the airlines determined that their aircraft had flown sufficient miles to require scheduled maintenance under the agreement, they would notify petitioner where the aircraft would be located at a specific time. Because not all airport facilities were susceptible to repair and installation of gears and parts on wide-bodied aircraft, petitioner had to deliver these items at the time and place scheduled by the buyer. Petitioner provided overhauled gears and parts previously obtained from other buyers and exchanged them for the current buyer's used parts. Exchanged parts were then taken back to petitioner's REDACTED TEXT facilities for overhaul and resale.

Petitioner stated that when it negotiated these contracts, it was one of a limited number of companies nationwide capable of overhauling and repairing landing gear. It stated there was no attempt to establish a place of business outside of REDACTED TEXT since most of its clients sought it out. Petitioner alleged that it negotiated all contracts through its home office in REDACTED TEXT. Petitioner stated that an independent contractor REDACTED TEXT who represented it in the Caribbean and South America was domiciled in the State of California during the audit period in this dispute. Petitioner alleged, however, that REDACTED TEXT was not acting as its agent within the State although Petitioner admitted he received and transmitted information, messages, and other forms of communication from REDACTED TEXT to petitioner. Petitioner analogized to a "conduit,[11] stating that REDACTED TEXT was previously acquainted with REDACTED TEXT who had been employed as an airline pilot. Therefore, petitioner stated REDACTED TEXT felt at ease relaying messages to petitioner through REDACTED TEXT

The tax auditor determined that petitioner's records documented over 200 recurring sales of landing gear parts and over 150 sales of landing gear, all of which were delivered, exchanged and/or installed at California airport facilities. These transactions were audited on an actual basis.

The tax auditor's investigation disclosed numerous instances in which sales managers, sales representatives, and production service representatives travelled into California. The Department of Business Taxes, (hereinafter, the DBT) alleged that numerous of these trips were to facilitate performance of past contracts and sales or to promote future sales, as well as to provide services in connection with the use, storage, or consumption of the landing gear and parts within this state under its contracts, including installation of the gears or parts. Petitioner alleged that numerous trips noted by the tax auditor were.to attend trade fairs and conventions and that those trips relating to its contracts were of short duration for purposes of providing technical assistance under its contracts. The latter trips were alleged to have been for administration of the agreements mostly, rather than to obtain orders. Petitioner contended that if you added the activities of their representatives to the presence of REDACTED TEXT as an independent contractor who was not authorized to initiate contracts in this State, petitioner's presence still did not sufficiently provide nexus by which to invoke a statutory duty to collect use tax and that this duty violated petitioner's due process rights.

Some of the disputed transactions involved sales to_ REDACTED TEXT._ A separate audit of REDACTED TEXT, returns disclosed that many, but not all, transactions involving sales by petitioner were reported. Petitioner billed REDACTED TEXT for the difference based

upon the results of this audit. REDACTED TEXT paid petitioner in full, but petitioner contended it should not owe interest on amounts due from sales to REDACTED TEXT. Should it ultimately be determined that petitioner had no duty to collect use tax, an issue of excess reimbursement arises. that petitioner had no of excess reimbursement arises.

Petitioner contended that the failure to file penalty should not apply to it for the following reasons:

1. Under its contracts with its clients, petitioner had the right to invoice them for any use taxes involved. Petitioner alleged it would not have subjected itself to this potential liability for interest and penalties if it truly believed use tax was due.

2. This was petition's first audit and it believed in good faith that no tax was due.

3. Petitioner's scope of business is nationwide. It was not attuned to the intricacies of California tax law, nor did it intend to take advantage of the California marketplace by engaging in business here.

4. Petitioner believed that was REDACTED TEXT acting as an independent contractor solely limited to Caribbean and South American locations. Therefore it believed that it had no duty to collect taxes because it perceived no nexus with the State through him or his activities.

5. All contracts for the repair, replacement, or overhaul of landing gear er parts were FOB in REDACTED TEXT. At the time of contracting, petitioner was not aware where the exchange of the gears or parts would take place. Therefore, it would have been unable to collect use tax at the time of contracting.

Analysis and Conclusion

Revenue and Taxation Code §6203 provides, in pertinent part, as follows:

> "·..every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state,...shall, at the time of making the sales or, if the storage, use, or- other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt

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therefor in the manner and form prescribed by the board....

"'Retailer engaged in business in this state' as used in this and the preceding section means and includes any of the following:

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"(b) Any retailer having any representative, agent, salesman, canvasser, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property...."

I find petitioner was a retailer engaged in business in this State and that its activities were sufficient to create nexus requiring it to collect use tax from its sale of tangible personal property for storage, use, or other consumption in this State.

The case of American Airlines Inc. v. State Board of Equalization, 216 Cal.App. 2d 180 (1963) clearly establishes the landing gear and parts sold by petitioner FOB Miami were susceptible to use tax when. delivered and installed in California. In that case, an airline carrier purchased engines, propellers, and other parts which were repaired and overhauled outside the State but were installed, used, consumed, or otherwise stored in California. There, as here, it was not known at the time of the purchase that there would be some use, storage, or consumption of specific parts within California. In this case, too, the facts clearly demonstrate consumption, use, or storage in California. "At the very moment when the tax was applied however in California the personal property had. come to rest in this state and was not being put: to use in interstate commerce. The tax in question is due but once." (American Airlines, ibid, p. 134.) (See also: Southern Pacific Company v. Gallagher, (1938) 306 U.S. 167; The Atchison. Topeka, and Santa Fe Railroad Company, *v.* State Board of Equalization, 131 Cal.App.2d 677 (1955); The Atchison, Topeka, and Santa- Fe Railroad Company v. State Board of Equalization, 139 **Cal.App.2d** 411 (1956).]

The court in American Airlines, supra. at p. 194, citing Southern Pacific, supra. at p. 177, stated:

"[W]e think there was a taxable moment when the former had reached the end of their interstate transportation and had not begun to be consumed in interstate operation. At that moment, the tax on storage and use--retention and exercise of right of ownership, respectively--was

effective. The interstate movement was complete. The interstate consumption had not begun."

The United States Supreme Court has previously disposed of the issue concerning the possibility of double taxation or personal liability of an outstate seller who fails or refuses to collect tax from a resident consumer. [See: Norton Company v. Illinois Revenue Department, 340 U.S. 534, 537; 95 c.Ed. 517, 71 S.Ct. 377 (1951).]Since the property can only be initially affixed once before it is placed in service in interstate commerce, petitioner's due process rights are not violated based on a potential for double use tax liability.

Petitioner established nexus with this State sufficient to impose its liability to collect tax based upon several business activities in which it engaged. First, petitioner had an independent contractor/agent who .resided in this State. That agent, identified as REDACTED TEXT, transmitted orders and relayed other information from one of petitioner's customers, REDACTED TEXT to petitioner's head office. Petitioner repeatedly allowed REDACTED TEXT to operate in this manner and acted in response to REDACTED TEXT transmittals. While REDACTED TEXT may not have had express authority to solicit sales in California due to territorial assignments petitioner may have given to its independent contractors, he nevertheless engaged in business activities on petitioner's behalf which generated gross receipts and/or perpetuated an ongoing business relationship from which gross receipts were derived. Those transmittals from REDACTED TEXT apparently resulted in the delivery of merchandise for storage, use, or consumption in this State under the maintenance schedule in REDACTED TEXT contract(s).

In Standard Pressed Steel Company v. Washington Revenue Department, 419 U.S. 560, 42 L.Ed. 2d 719, 95 S.Ct. 706 (1975), the court dismissed as frivolous an argument that the seller's in-state activities were too thin and inconsequential to impose a duty to collect tax because no benefits were conferred. In Standard Pressed Steel, the State of Washington imposed liability on a corporation for activities of a single employee, an engineer whose office was in his personal residence, and who was responsible for consulting with that petitioner's sole Washington-based customer regarding anticipated needs for this supplier's product. The court found that those contacts had sufficient relationship to the activity within the State producing gross receipts to support imposition of a tax. While Standard Pressed Steel imposed a gross receipts tax, where there is a greater hazard of multiple taxation, the level of in-state activity--including the negotiation of contracts with that client by that petitioner's out-of-state main office, clearly parallelssl3 the situation in this case. I find no

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distinguishable facts in this case that would merit a different result.

It is indisputable petitioner recognized from prior dealings that at the time of their formation, numerous FOB REDACTED TEXT contracts could require delivery and installation of tangible personal property in this State. In fact, over 250 deliveries of parts and over 150 deliveries of repaired or overhauled landing gear were documented from petitioner's books and records. This consistent and recurring activity of delivering tangible personal property for installation at California airport facilities, and the provision of technical assistance by petitioner's employees in this State, is an alternative ground upon which I have determined petitioner was engaged in business in the State of California.

Finally, petitioner's instate activities were not limited to providing technical assistance. Petitioner received used parts at the time of delivery of new ones: The exchange parts were taken into inventory and eventually resold after overhaul. In addition to the presence of an agent in this State, petitioner repeatedly sent sales managers and sales representatives into the State for purposes of facilitating delivery of tangible personal property under its FOB REDACTED TEXT contracts and to perform installation and technical assistance under those contracts. In National Geographic v. California Equalization Board, 430 U.S. 531m 51 L.Ed. 2d 631, 640; 97 S.Ct. 1386 (1977), the court stated

> "[t]he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the state, but simply whether the facts demonstrate 'some definite link, some minimum connection, between (the State and] the person...it seeks to tax.' Miller Brothers v. Maryland, 347 U.S. 344-345, 98 L.Ed. 744, 74 S.Ct. 535. (Emphasis added.)"

Petitioner testified that

Petitioner contracted with the airlines under the express understanding that scheduled maintenance by delivery of restored or repaired parts would occur at various locations throughout the country. Hundreds of deliveries of gears and parts within the State of California clearly established a "link" and a "minimum connection" in an on- going business activity sufficient to merit imposition of the duty to collect taxes.

Petitioner's repeated conduct of sending sales managers, sales representatives, and employees to supervise the installation of these landing .gear in California constitutes a further business activity engaged in within this state in connection with the aforementioned out-of-state sales sufficient to establish nexus.

In this regard, it is irrelevant that petitioner did not maintain its own offices or facilities in which to have its personnel install the gear in California. (Standard Pressed Steel, supra.) Revenue and Taxation Code §6203 (b) does not require a business facility be located in this State; delivering or taking orders for tangible personal property for instate delivery through an agent suffices to establish that a retailer is engaged in business in this State.

Petitioner clearly benefitted from municipal and local services sufficient to merit imposition of a duty to collect tax. Petitioner's employees utilized the public roads, motels, conveyances, and airports in order to perform its contractual duties. The State of California provided not only local retailers, but also petitioner, "with the same municipal services--fire and police protection; and the like." (National Geographic, supra. at p. 651)

Based upon the arguments raised by petitioner, imposition of a 10 percent penalty for failure to to file returns is not merited. This was petitioner's first audit and petitioner proffered a colorable argument concerning nexus.

Recommendation

Redetermine in accordance with the reaudit dated January 18, 1989, except delete the failure-to-file penalty.

Janice M. Fallman, Hearing Officer

November 7, 1990
Date

cc: All Libraries
All Audit Supervisors
B. Kaudse
D. Carroll