

M e m o r a n d u m**305.0028.200**

To: Mr. Vic Anderson
Audit and Information Section (MIC:44)

Date: February 6, 2006

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Subject: **S---, R--- and C---**
SR --- XXX-XXXXXX
Off-Reservation Sales to Indians

This letter responds to your August 19, 2005, memorandum to Acting Assistant Chief Counsel Selvi Stanislaus requesting analysis of the application of tax to sales to Indians by S---, R--- and Co. (S---) or its contract dealers under the circumstances described below. Attached to your memorandum are: (1) a June 10, 2005, memorandum to you from Mr. Wayne Hopkins, Out-of-State District Principal Auditor; (2) an April 27, 2005, memorandum to Mr. Jeffrey McGuire, Chief of the Tax Policy Division, from Tax Counsel IV John Abbott concerning contract carrier deliveries to Indian reservations; and (3) a March 28, 2005, letter to Mr. Hopkins from Mr. J--- V---, attorney for S---, with six exhibits: (Ex. 1) a document entitled "Master Agreement for Home Delivery Services" (Master Agreement) between S--- and T--- F--- H--- Co., doing business as S--- L--- S--- (SLS)¹; (Ex. 2) a document entitled "S--- Authorized Retailer Agreement" (Retailer Agreement) between L--- J. G--- and S---; and (Exs. 3 through 6) both a S--- "sales check" and a "unit certificate of exemption" for each of four purchases by four different customers, each identified as a "tribal member" or "member" of a "tribe."

You ask three related questions. First, you ask whether staff properly disallowed claimed exempt sales to Indian purchasers who reside on a reservation on the ground that the sales occurred off the reservation, i.e., when S--- transferred the goods to carrier SLS, for delivery to the customer. You note that staff concluded that SLS was a contract carrier. Second, you ask whether sales to Indian purchasers who reside on a reservation are subject to tax when the goods are sold by contract operators that own and operate their own stores, stock goods owned by S---, receive a commission from S--- in connection with the sale of the goods, and deliver the goods by means of the contract operators' own trucks. Third, with regard to each type of transaction you ask whether the retailer may accept the "unit certificate of exemption" from the Indian purchaser in good faith.

¹We note that counsel did not provide any of the "exhibits, schedules, attachments, addenda, supplements, etc." which together with the Master Agreement comprise the entire agreement between S--- and SLS. (See section 29 of the Master Agreement.)

Subject to the assumptions, qualifications and limitations set forth in this memorandum, we conclude that: (1) certain of the transactions in question should have been allowed as exempt sales to Indian purchasers who reside on a reservation; (2) the contract operators are retailers, so that when a contract operator (retailer) delivers goods in its own trucks, title and possession passes to the Indian purchasers upon delivery on the reservation and the sales are not subject to tax; and (3) the "unit certificate[s] of exemption" are not valid and may not be accepted in good faith because S--- (or the contract operator) prepared the certificates and obtained the signatures of Indian purchasers prior to delivery, and the certificates, thus, improperly attest to delivery events which had not yet occurred.

In responding to your questions, we understand and assume that S--- is an off-reservation retailer. We also understand and assume that SLS distribution centers are not located on a reservation. We assume that SLS delivers merchandise using its own trucks. We additionally understand and assume that each purchaser is an Indian, and resides on a reservation, as these terms are defined in California Code of Regulations, title 18, section (Regulation) 1616, subdivision (d)(2). We further assume that the contract operators do not have business premises on a reservation.

Discussion

Regulation 1616(d)(4)(A) explains how tax applies to sales to Indians by off-reservation retailers. That subdivision provides that when an off-reservation retailer makes a sale of tangible personal property to an Indian negotiated at a place of business off a reservation, that sale is not subject to tax if the delivery is made to the Indian purchaser on a reservation and title (ownership) transfers to the Indian purchaser on a reservation. In other words, Regulation 1616(d)(4)(A) requires that possession and title (ownership) pass to the Indian purchaser on the reservation in order for the sale to be exempt from tax. Regulation 1616(d)(4)(A) further explains that generally, title (ownership) to the property transfers upon delivery if delivery is made by facilities of the retailer, and ownership transfers upon shipment if delivery is made by mail or carrier. (*Ibid.*) If the property is delivered off the reservation or the ownership transfers to the purchaser off the reservation, the sale is subject to tax. (*Ibid.*)

Regulation 1628 sets forth an expanded definition of where a sale takes place. Specifically, Regulation 1628(b)(3)(D) incorporates provisions of California Uniform Commercial Code section 2401² to explain when title passes, and the sale occurs, under

² California Uniform Commercial Code section 2401(2) provides:

- (2) "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading.
 - (a) If the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes on to the buyer at the time and place of shipment, but
 - (b) If the contract requires delivery at destination, title passes on tender there."

circumstances when goods are delivered to the purchaser by mail or carrier, or by the facilities of the retailer. Thus, Regulation 1628(b)(3)(D) provides more specific guidance regarding title passage and the place of sale than the general provisions of Regulation 1616(d)(4)(A) discussed above.

Regulation 1628(b)(3)(D) provides:

“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 reference 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 reference to the physical delivery of the property 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 another time.*” (Emphasis added.)

We note that the Board’s Regulation 1628, including subdivision (b)(3)(D), was enacted in 1971, and was amended in 1984 to include the explanatory language italicized above. Thus, when a sale occurs is determined currently, as it has been historically, by the provisions of California Uniform Commercial Code section 2401 that are incorporated in the Board’s regulations. The statement by S---’s counsel that the Board should be required to apply Commercial Code section 2401 in reality asks the Board to continue its present and historical policy. However, as we discuss below, we disagree with S---’s counsel’s analysis of section 2401 under the facts stated and assumed herein.

In the sections below, we will separately address the application of tax to two different types of transactions. First, we discuss sales by S---, when the are goods delivered by SLS to the Indian customers. Thereafter, we discuss sales by S---’s contract operators, when the goods are delivered by the contract operators’ own trucks to the Indian purchasers on a reservation.

S--- and SLS

Delivery Requirements

In determining whether tax applies to sales made by retailer S--- and delivered to Indian purchasers by carrier SLS, the transaction must be analyzed under Regulation 1616(d)(4)(A), with reference, as necessary, to Regulation 1628(b)(3)(D). That is, in order for the sale to be exempt, title and possession must in fact pass to the Indian purchaser on the reservation. We have previously concluded that when delivery to the Indian purchaser is by contract carrier or

common carrier, the following conditions must be met in order for title and possession to pass to the Indian purchaser on the reservation: (1) the contract of sale (or an equivalent document) must expressly contain an F.O.B. reservation or equivalent provision; (2) title cannot have been passed to the purchaser prior to delivery on the reservation; and (3) the goods must in fact be delivered to the Indian purchaser on the reservation as specified in the contract of sale. (Later in this memorandum, we discuss how to establish that goods are in fact delivered to the Indian purchaser on the reservation, when delivery is by common or contract carrier.)

We analyze the sales at issue here under the above criteria. In each of the sales presented as examples, S---'s counsel provided a "sales check" and "unit certificate of exemption" for each of the four Indian purchasers (Ex. 3, 4, 5 and 6). We assume that S--- prepared each sales check and each unit certificate of exemption. Each unit certificate of exemption appears to be signed by the Indian purchaser. Each Indian purchaser's sales check bears the same date as that purchaser's unit certificate of exemption, and in each case, delivery is specified to take place on a different, and later date. Accordingly, we assume that in each case the sales check and unit certificate of exemption were issued by S--- and executed by the Indian purchaser at the same time the sale was negotiated off the reservation.

Each unit exemption certificate states (1) "ORGANIZATION NAME" followed by the name of the Tribe or the reservation, and (2) "DELIVERED TO RESERVATION" followed by the name of the reservation, or the term "yes," or a specific address. In each case, the unit certificate of exemption was issued contemporaneously with the sales check, and therefore may be considered a part of the contract of sale. Thus, the first condition described above has been fulfilled, i.e., that delivery on the reservation is specified in the contract of sale or equivalent document. We note that S---'s counsel incorrectly states that language in the contracts between S--- and carrier SLS (Ex. 1, § 11) and between S--- and its contract operators (Ex. 2, § 4.2) act to retain title in S--- until the goods are delivered to the purchaser. In order for title to transfer at delivery, the contract of sale or equivalent document between the purchaser and the retailer, in this instance S--- (or the contract operator) and the Indian purchaser, must specify that title is to pass upon delivery. (See Reg. 1628(b)(3)(D).) Neither the contract between the retailer S--- and the carrier, nor the contract between S--- and the retailer contract operators³ is determinative with respect to this first condition.

Next, we note that the second condition has also been fulfilled, i.e., that title has not been passed to the purchaser prior to delivery on the reservation, as there is no indication in the documentation or other information provided that S--- and any Indian purchaser agreed that title was to transfer before delivery. To determine whether the third condition was fulfilled, i.e., that the goods were in fact delivered to the Indian purchaser on the reservation as specified in the contract of sale, we look to the specific circumstances of these transactions.

As the first step in our analysis, we discuss staff's determination that SLS is a contract carrier. S---'s counsel provided, as Exhibit 1, the Master Agreement between S--- and SLS, in which S--- agreed, with limited exceptions, "to exclusively utilize the services of SLS for home

³ See discussion, *infra*, of contract operator as retailer.

delivery” of S--- merchandise (see section 3 of the Master Agreement).⁴ In view of the fact that SLS’s dba includes the name of the retailer “S---” (the full name of carrier SLS is “T--- F--- H--- Co., doing business as S--- L--- S---”), we assume that SLS does not offer its transportation services “indiscriminately to the public or some part of the public” and thus does not qualify as a common carrier. (See, e.g., Reg. 1621(a)(1); see also Regs. 1541.5(a)(4), 1593(a)(2).⁵) We thus conclude, in agreement with staff, that SLS is a contract carrier.⁶ (See section 10 of the Master Agreement.)

Next, we analyze the nature of the relationship between carrier SLS and retailer S--- with regard to delivery of S--- merchandise. As noted, under the Master Agreement, which is dated January 1, 1990, S--- had an exclusive relationship with SLS concerning certain types of deliveries. Specifically, the Master Agreement requires that S--- deliver (or cause to be delivered) S--- merchandise to SLS distribution centers, for subsequent delivery by SLS to S---’s customers (see sections 1 and 3 of the Master Agreement).⁷

The Master Agreement for deliveries does not include deliveries from a S--- store to a S--- customer. (*Ibid.*) Thus, we assume that the merchandise at issue here was located at an SLS distribution center in preparation for ultimate delivery to a S--- customer. We further assume that retailer S--- has control over carrier SLS’s delivery, so that delivery of S--- merchandise occurs as specified in the contract of sale between S--- and its customer.

Accordingly, we assume that carrier SLS can provide documentation to verify the delivery of the merchandise in question to the Indian purchaser on the reservation, as specified in the contract of sale. If the existence of such documentation is established in audit, the third requirement has been fulfilled for transfer of title and possession to the Indian purchaser on the reservation. We conclude that under the facts stated and assumed, title and possession transferred from retailer S--- to the Indian purchaser on the reservation, and the sales are, therefore, exempt from sales tax.

Exemption Certificates

As we have noted, the unit certificates of exemption were prepared by S--- for Indian purchasers’ signatures, and were signed by the Indian purchasers contemporaneously with the issuance of the sales checks (Exs. 3 through 6). However, the unit certificates of exemption are not valid as issued and executed, and thus may not be accepted by S--- in good faith (see Reg. 1667), because each certificate states that the purchased goods were “delivered to reservation” despite the sales check stating a delivery date some days after the sales check was issued. The purchaser cannot attest to an event that has not yet occurred. (See, e.g., Evidence Code section 702.) In addition, each of the unit certificates of exemption erroneously states that the claimed basis of exemption was “NATIVE AMERICANS – DELIVERED TO THE

⁴ SLS provides trucks for the deliveries (see section 1 of the Master Agreement).

⁵Each of these regulation defines “common carrier” to mean any person who engages in the business of transporting persons or property for hire or compensation and who offers these services indiscriminately to the public or some portion of the public.

⁶We note that S---’ counsel does not consider this issue in his March 28, 2005, letter to Mr. Hopkins.

⁷We assume that the provisions of the Master Agreement, as set forth in Exhibit 1, remain in effect.

RESERVATION BY S--- OWNED TRUCK.”⁸ Under the circumstances described, the retailer S--- does not own the delivery vehicles. Rather, the delivery vehicles appear to be owned by the carrier SLS.

Because the “unit certificate of exemption” is not a valid exemption certificate in the “Delivery Requirements” analysis above, we instead determined whether S--- established with documentary evidence that the sales are exempt from tax. (See Sales and Use Tax Memorandum Opinion *Holiday World, Inc.* (8/1/01).) We suggest, however, that S--- develop a new template for the contract of sale that uniformly and accurately provides the information necessary to support an exemption from tax under Regulation 1616(d)(4)(A) and 1628(b)(3)(D).⁹

Contract Operators

Contract Operator as Retailer

We next address the application of tax to sales by contract operators. Your memorandum indicates that this category consists of transactions in which goods are purchased from a S--- contract operator, and delivered to the Indian purchaser on a reservation by the contract operator’s own trucks. You further state that these transactions are supported by documentation in a format substantially identical to the documentation provided in Exhibits 3 through 6.

As a starting point, under the facts as stated and assumed, we have concluded that the contract operator, not S---, is the retailer, as discussed below.

Regulation 1569, adopted pursuant to Revenue and Taxation Code section 6015, explains:

“A person who has possession of property owned by another, and also the power to cause title to that property to be transferred to a third person without any further action on the part of its owner, and who exercises such power, is a retailer when the party to whom title is transferred is a consumer. Tax applies to his gross receipts from such a sale.”

Each of the regulation’s requirements is met here. First, under the sample contract entitled “S--- Authorized Retail Agreement” (Retail Agreement) provided by S---’s counsel (Ex. 2), the S--- Authorized Retail Dealer (contract operator) has possession of the property owned by S---. (See sections 3.1, 3.4, 4.1, and 4.2 of the Retail Agreement.) Second, S--- has given the contract operator the power to cause title to that property to be transferred to a consumer without any further action by S---. (See sections 4.1 and 4.5 of the Retail Agreement.) Third, under the circumstances described, we understand and assume that the contract operator is exercising that power and is, thus, making sales to customers. Fourth, we assume that the customer to whom

⁸Under Section 1 of the Master Agreement, SLS is to provide trucks for the deliveries. (See footnote 4, *Supra.*) Accordingly we assume that the trucks used by SLS for the deliveries do not belong to S---.

⁹For example, we note that the “unit certificate[s] of exemption” variously describe the “business” as “reservation” (Ex. 3), a series of numbers (Ex. 4), the name of the Tribe (Ex. 5), and “Tribal Council” (Ex. 6).

title is transferred is a consumer. (See section 4.1 of the Retail Agreement [“... Dealer shall not sell Merchandise to customers for resale or for commercial use and shall not purchase Merchandise for resale to customers.”].) We note that the Retail Agreement itself provides in section 4.2 that “the relationship established between S--- and Dealer [contract operator] ... shall be a consignment relationship.”

Delivery Requirements

Based on Regulation 1569, therefore, the contract operator, not S---, is the retailer of the goods. Accordingly, when the contract operator (retailer) delivers goods by means of its own trucks, title transfers, and the sale occurs, upon transfer of the goods to the purchaser (unless the parties have previously agreed that title is to pass at an earlier time). When the Indian purchaser resides on a reservation, and delivery in fact occurs on a reservation, title transfers there and the sale is exempt from tax under Regulation 1616(d)(3)(A)1.

Exemption Certificates

Under the circumstances here, the “unit certificate[s] of exemption” are not valid exemption certificates. The certificates provided as examples do not accurately reflect the circumstances pertinent to the contract operators, e.g., that the contract operators are retailers, and the goods are delivered by the contract operator’s (retailer’s) own trucks. Furthermore, as discussed above, the certificates improperly attest to delivery events that have not yet occurred. We suggest, as we did with regard to S---, that a new template be developed for a contract of sale that correctly provides, on a uniform basis, the evidence required to support an exemption from tax under Regulations 1616(d)(4)(A) and 1628(b)(3)(D).

Because the “unit certificate[s] of exemption” are not valid exemption certificates, the contract operators must establish with documentary evidence that a sale is exempt from tax. (See Sales and Use Tax Memorandum Opinion *Holiday World, Inc.* (8/1/01).) Although invalid as exemption certificates, as we have discussed above, each certificate contains information relevant to determining whether the sales to Indian purchasers are exempt from tax. We suggest that the sales agreement be amended to include, uniformly and accurately, information to establish the agreement of the parties to the terms of delivery. In addition, we suggest that the contract operators obtain exemption certificates from Indian purchasers upon delivery of the goods to the reservation. (Reg. 1667.)

We will be happy to discuss any questions you have after review of this memorandum.

CJC:ds

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