

**M e m o r a n d u m****325.0115**

To: Out-of-State District (JF)

Date: August 17, 1987

From: Legal (RLD)

Subject: Application of Use Tax to Use of Carpet Samples

This is in response to your telephone inquiry of May 29, 1987, to Tax Counsel James Mahler.

We understand that, during your audit of a carpet manufacturer in Georgia, you uncovered the following factual situation. The manufacturer in Georgia gives samples of carpets to California retailers for use by the retailers. The manufacturer places the address of the California retailer on the samples in Georgia and ships the samples by common carrier to the manufacturer's employees in California. The manufacturer's employees then forward the samples to the California retailers. Given these facts, you asked whether the manufacturer is responsible for payment of California use tax.

We believe that, under the facts you presented, the Georgia manufacturer makes a taxable use of the carpet samples at the time that the employees in California forward the carpet samples to the California retailer. We further believe that, until that time, the manufacturer has not relinquished ownership of the samples notwithstanding that the manufacturer may have preaddressed the samples out of state.

You sent for our review a copy each of three memoranda in which, under similar circumstances, the Board's legal staff took the position that the use tax would not apply in such a situation on the basis that the property would be continuously in interstate commerce from the time it is shipped until the delivery to the addressees in California.

We disagree with that conclusion when the fact show, as here, that the donor ships property to California and regains possession of the property before delivering it to the donee.

In the case Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, the United States Supreme Court provided the contemporary approach to the ability of a state to impose taxes directly upon businesses engaged in interstate commerce activities within the taxing state. The court interpreted the commerce clause of the United States Constitution (U.S. const., Art. I, § 8, Cl. 3) as requiring that a state tax will be valid only if "the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state." (430 U.S. 279.)

We believe that, when an out-of-state business brings or ships property into California for the purpose of making a gift of the property in California, the activity certainly has a substantial nexus with California. We believe that the use tax is fairly apportioned; that is, the tax is apportioned in a manner directly related to the activity taxed, the use of the property in California when the property is given to the donee. All of such taxable use occurs in California. On the other hand, if the state of Georgia considers the gift of the carpet samples as occurring at the time that the samples are withdrawn from inventory and addressed to the donees, such that Georgia imposes its use tax, California provides for a credit for that tax paid to Georgia (Rev. & Tax. Code § 6406). We further believe that California's use tax in such a case does not discriminate against interstate commerce. California imposes the use tax at the same rate regardless of whether property is purchased out of state for the purpose of making a gift in this state or the property is withdrawn from resale inventory in this state for such purposes. We believe that California's imposition of the use tax on the use of the carpet samples is fairly related to the services provided by the state. The manufacturer's employees, with jobs in California, make possible the realization and continuance of valuable contractual relations between the out-of-state manufacturer and the California retailers. (See Standard Pressed Steel Company v. State of Washington Department of Revenue, 419 U.S. 560, 562.)

The memoranda you sent which concluded that use tax would be inapplicable to such facts were based upon an approach to the commerce clause which predated the ruling of the Court in Complete Auto Transit, supra. One of the memoranda, dated April 3, 1967 to Headquarters – Audit Review from Tax Counsel Glenn R. Rigby, reasoned that imposing the use tax in such a situation would be similar to imposing sales tax on the sale of property which is sent to a seller's agent in California for delivery to the purchaser. Such a sale would have been exempt from tax as a sale in interstate commerce. (Ruling 55, subd. (a)(1)(A)3.) The underlying principle remains the same since the date of that opinion. However, if the out-of-state retailer's agent who makes the delivery in California is an "other place of business" in California of the out-of-state retailer, then the sale occurs in California, and the sales tax would apply.

Since the date of Mr. Rigby's opinion, Ruling 55 has been amended and renumbered as Sales and Use Tax Regulation 1620, Interstate and Foreign Commerce. Subdivision (a)(2)(A) of the regulation no defines "other place of business" to include the homes of resident employees who perform substantial services in relation to the retailer's functions in this state, particularly in relation to sales. Therefore, if an out-of-state retailer ships property to such a California resident employee of the out-of-state retailer for delivery to the consumer, the sale would occur in California, and sales tax would apply. We believe the regulation supports our similar conclusion that, where an out-of-state retailer ships property to its resident employees in California for delivery to donees in California, then the use of the property by the donor occurs in California, and the use tax is applicable.

We hope this answers your question; however, if you need further information, feel free to write again.

RLD:sr