STATE BOARD OF EQUALIZATION
LEGAL DIVISION (MIC:82)
450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
TELEPHONE (916) 324-2637
FAX (916) 323-3387

February 23, 1998

Mr. -. S--- N---
--- --- --- LLP
XXXXX --- Street, Suite XXXX
--- ---, California XXXXX

Re: Unidentified Taxpayer

Dear Mr. N---:

This is in response to your December 15, 19XX letter regarding the application of tax to your unidentified client's (hereafter "the Company") operations.

You request a "ruling" pursuant to Revenue and Taxation Code section 6596[1] which you acknowledge is not binding on this Agency. I initially note that only the elected members of the Board may issue a ruling with respect to matters properly before them, and that staff can only issue an opinion as to how tax may or may not apply to a particular set of facts. You also acknowledge that our opinion is not binding since you did not identify the taxpayer (and possibly all relevant facts), but nevertheless request that our "ruling" be made pursuant to section 6596. This is perplexing. An opinion from this Agency is made pursuant to section 6596 only when all the conditions of that section are all satisfied, including the disclosure of the parties and all relevant facts. This opinion is not pursuant to section 6596 since you did not identify the taxpayer (and possibly all relevant facts). As a practical matter, an unidentified taxpayer (or its representative) cannot obtain a "non-binding" letter "pursuant to California Revenue and Taxation Code . . . [section] 6596" as you request.

With this in mind, you provide the following facts:

> "The Company provides sales invoices (that contain various advertisements on the bottom) free of charge to certain retail establishments -- and pays the recipients a fee to ensure usage of the invoices to further promote the advertisements contained therein. The sales invoices are shipped from California by the printer to recipients located outside California.

[1] All further references are to the Revenue and Taxation Code unless otherwise specified.

> "The invoices must be used during a specific period, because the advertisements are valid for a limited time period and contain an expiration date. The recipients are required to return all unused invoices, since they are not suitable for their intended use. The Company sends the recipients a quantity of invoices that it believes the recipients will fully consume during the periods of intended use. It is not the intent of the Company to send excess invoices for the purpose of storing and subsequently returning the invoices to the Company. The sales invoices do not qualify as printed sales messages pursuant to Regulation 1541.5."

I understand you to ask whether tax applies with respect to the Company's transfer of its invoices to the out-of-state retail establishments and whether tax applies when any unused invoices are subsequently returned to California. You also ask whether the Company is making a gift or a loan of the invoices to the out-of-state establishments.

Discussion

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (§ 6051.)[2] When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption of that property in California. (§§ 6201, 6401.)[3] Taxable gross receipts or sales price generally include all amounts received with respect to the sale, with no deduction for the cost of materials, service, or expense of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (§§ 6011, 6012.)

You place much relevance in your efforts to characterize the transfer of the Company's invoices as a loan and not a gift. I do not believe this distinction is necessary.[4] You state that the Company pays certain retail establishments located outside California to use its invoices. You further state that these invoices are shipped from California by the printer to the out-of-state

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[2] This tax is imposed on the retailer who may collect reimbursement from its customer if the contract of sale so provides. (Civ. Code § 1656.1; Reg. 1700(a).)

[3] This tax is imposed on the person actually storing, using, or otherwise consuming the property. (§ 6202.) A retailer engaged in business inside this state is required to collect this tax from its customers and remit it to this Board. (§§ 6202, 6203.)

[4] Though not relevant, the application of tax to gifts and loans of property is dependent on several factors. Where a gift is purchased and the purchaser directs the vendor to ship it to an out-of-state donee, the sale occurs in interstate commerce and is not subject to tax. (BTLG Annot. 280.0620 (12/6/61); Reg. 1620(a)(3)(B).) Conversely, a donor is liable for use tax when he or she makes a gift of extax property inside this state. (See BTLG Annots. 280.0040 (10/11/63), 280.0640 (3/15/60).) The loan of tangible personal property for use inside this state is a taxable use of that property. (See BTLG Annot. 570.0180 (3/8/68).) The loan of tangible personal property delivered outside this state for use solely outside this state is not a taxable use of the property by the lendor. (BTLG Annot. 570.0200 (2/2/65).) The difference between a gift and loan of tangible personal property is whether there is an obligation to return the property. (BTLG Annot. 280.0670 (5/14/84).)

establishments. I assume from your description that the printer directly ships the invoices to the out-of-state establishments via common carrier and that the Company (or its agents) does not obtain any physical possession of the invoices prior to that shipment. (If my assumption is incorrect, my opinion below might be different.) Under these facts, the printer's sale of invoices to the Company is an exempt shipment in interstate commerce pursuant to section 6396 and Regulation 1620(a)(3)(B). This sale is not subject to tax regardless of whether the Company is making a gift or loan of the invoices to the out-of-state retailers, or whether the Company pays the out-of-state establishments to use the invoices.

You next ask whether tax applies to the unused invoices that are returned to California. Though not directly on point, Regulation 1620(b)(3) explains when property is regarded as purchased for use inside this state:

> "[P]roperty purchased outside California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California. When the property is first functionally used outside of California, the property will nevertheless be presumed to have been purchased for use in this state if it is brought into California within 90 days after its purchase unless the property is used or stored outside of California one-half or more of the time during the six-month period immediately following its entry into the state. Prior out-of-state use not exceeding 90 days from the date of purchase to the date of entry into California is of a temporary nature and is not proof of an intent that the property was purchased for use elsewhere. Prior out-of-state use in excess of 90 days from the date of purchase to the date of entry into California, exclusive of any time of shipment to California, or time of storage for shipment to California, will be accepted as proof of an intent that the property was not purchased for use in California.
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> "For purposes of this subparagraph, 'functional use' means use for the purposes for which the property was designed."

Based on this provision, we regard extax property to be purchased for use inside this state (and subject to use tax) where that property is first functionally used inside California. Property is also regarded as purchased for use inside California where the property is first functionally used outside California and is then brought into this state within 90 days after its purchase, unless the property is used or stored outside California one-half or more of the time during the six month period immediately following its entry into this state.

The Company sends invoices to out-of-state retail establishments. Some of the invoices are not used as sales invoices and instead are returned to the Company in California. Regulation 1620 presumes that these invoices are purchased for use inside this state if the first functional use of the property occurs inside California. I assume from your letter that the Company uses these invoices inside this state for any number of purposes such as (for example) tracking the number of unused invoices, recycling, destruction, or modification and reissuance. Under these facts, the use of invoices for any of these purposes (or possibly others) is a functional use since these returned invoices would now be used for a purpose suitable for outdated sales invoices. Tax therefore applies to the sales price of the sales invoices returned to the Company from the out-of-state establishments.

You believe that tax should not apply to the returned invoices where the return takes place at least 90 days after the Company's delivery to the out-of-state establishment. This is incorrect. The 90 day rule only applies where there is a first functional use of the property outside California. In this case, the returned invoices are never functionally used outside California such that the 90 day rule cannot apply. You also believe that tax should not apply to the returned invoices since the Company intended that they all be used outside the state. This too is incorrect. You state that "the recipients are required to return all unused invoices . . . ." I understand this to mean that the Company always intends that the invoices be returned to California if they are not used as actual sales invoices. Under these facts, there is no change in intent or in circumstances warranting a different result to the application of tax to the returned invoices. The annotations you cite relate to actual changes in intent or circumstances which are simply not evident here.

I trust this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Senior Tax Counsel

WLA:cl

cc: --- --- District Administrator (--)