

M e m o r a n d u m**710.0016**

To: Mr. Bob Wils (MIC:27)
Supervising Tax Auditor
Local Tax Section

Date: December 15, 1994

From: John L. Waid
Tax Counsel

Subject: S- -- XX-XXXXXX (O--- C---, Inc. dba O--- D---)
Local Tax Allocation of Catalogue Sales

I am responding to your memorandum to me dated October 26, 1994 regarding allocation of local tax revenues derived from catalogue sales by this taxpayer. You attached to your memorandum a copy of a memorandum to you dated August 3, 1994, from Mr. John Hadley of the Local Tax Section in which he recounted his telephone conversation that day with a Mr. H--- S---, who represents the taxpayer, which Mr. S--- placed in response to Mr. Hadley's letter of June 17, 1994, to the taxpayer, as follows:

“Mr. S--- stated that telephone operators are located at a facility in [city], but not at the registered sublocation. This facility is the western regional center for phone ordered catalog sales. The staff at the phone center does not set prices. The phone operators accept orders from catalog customers, and then send the order to the sublocation nearest the purchaser, based on the ZIP code given. The customer then picks up and pays for the merchandise at that facility; occasionally, the product is shipped to the purchaser, but this is not a common occurrence. It is also uncertain as to the volume of catalog sales on account.”

The taxpayer has numerous retail stores located throughout California. In his June 17th letter, Mr. Hadley indicates that the taxpayer is currently allocating the local tax revenue derived from these sales to the location from which the goods were shipped to the customer. Attached to his memorandum is a report of his conversation with Mr. S--- which records that Mr. S--- stated that the people at the [city] facility are not salesmen but merely take catalogue orders placed by the customer. When the customer gives his zip code, the operator determines which of the taxpayer's retail locations is closest to the customer and has the order sent there. The customer then goes to the retail store, accepts or rejects the order, and pays for it there. The orders are shipped FOB destination.

In our conversations on this matter, you have indicated that the taxpayer may account for such sales as being made only at the shipment facility and have no way of distinguishing direct sales made at its retail facilities from catalogue sales picked up there. I assume this information is derived from the audit of the taxpayer which Mr. Hadley also mentioned in his memorandum. As he notes, we should not issue a final conclusion on this until the audit is final. If it is still ongoing, however, you could ask the auditor to investigate this aspect of the matter.

This question is driven by a request dated December 23, 1993, by [name], representing the City of [city], to John Gibbs, Out-of-State District Principal Compliance Supervisor (a copy of which Mr. Hadley attached to his memorandum), that Local Tax instruct the taxpayer to properly allocate tax. [Name]'s request indicates that the taxpayer is currently allocating local tax revenue to the warehouse locations - either [city 2] or [city 3] - from which the order is shipped.

OPINION

It is axiomatic that, for there to be any sales tax revenue to allocate, there must be sales activity within the jurisdiction that levies the tax. Local sales tax is properly allocable to a warehouse location only in the event that the retailer's sole physical presence within California is a stock of merchandise. (Reg. 1802(b)(5).) We thus conclude that allocation to the shipping locations is incorrect because the sales activity that leads up to the sale occurs elsewhere. But what elsewhere?

In the case of phone-order sales, we have expressed the opinion previously that the principal negotiations are ordinarily made with the phone-order facility (frequently a boiler room), which makes that location the "place of sale" under Regulation 1802(a)(2). In the factual contexts under which those conclusions were made, however, we have either known or assumed that the customer's sole contact with the retailer was with the telephone order facility. The transaction was completed - the order given and payment made - over the phone. Here, the facts are different. The sale is clearly not made by the telephone order facility. The customer selects the desired item from the catalogue which sets the price and terms and orders it over the phone. The operator then determines to where the item must be shipped and has it shipped there. Neither title nor risk of loss has yet passed to the customer who must still go to the retail location to actually make the buy. The customer can either accept or reject the item and must pay for it at that time. Under these facts, then, the taxpayer does not complete its performance with respect to delivery until the customer obtains possession of the merchandise ordered. Although not determinative, it is significant that the taxpayer retains the risk of loss until the customer picks up the item. As a result, title does not pass and the sale is not made until the customer purchases the item at the retail location to which it is shipped. (Cal.Unif.Comm.Code § 2401; Annot. 495.0700.) We thus conclude that the place of sale is the retail location where the customer purchases the item ordered, and the local tax revenue derived from the sale should be allocated to the situs of the retail location.

We do note that the facts indicate that a few phone orders are shipped directly to the customer. Under our previous opinions, the local tax generated by these sales should be allocated to the [city].

In its letter, [name] requested "backquarters credit" under Board regulations. The Board has no regulations on this subject; the sole authority for allocating to previous quarters is Section 7209 which, in the event of a misallocation, permits the Board to allocate local tax back two quarters from the date that the Board obtains knowledge that a misallocation has occurred. That section is permissive only and does not require reallocation. We have previously determined that reallocation is not proper where the factual background is unclear and the determination of the proper place of sale is the issue. In this case, we are only just now determining where is the proper place of sale. It is significant that both the actual allocation by the taxpayer and the suggested re-allocation by [name] are incorrect. We thus recommend that there be no backwards reallocation in this case, and there only be forward allocation beginning on the first day of the first calendar quarter that occurs after the place of sale is finally determined.

JLW:te