280.0205

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
REDACTED TEXT, INC.	)	No. SR BHA REDACTED TEXT
Petitioner	)	

The Appeals conference in the above-referenced matter was held by John Frankot, Staff Counsel on August 4, 1993 in Sacramento, California.

Appearing for Petitioner:	REDACTED TEXT Vice President, Finance
Appearing by Telephone:	REDACTED TEXT Tax Manager
	REDACTED TEXT State & Local Tax Accountant
	REDACTED TEXT, Inc. (Parent Company)
Appearing for the Sales and Use Tax Department:	Kevin Hanks Senior Tax Auditor
In Attendance:	Rachel Aragon Staff Counsel

Protested Item

The protested tax liability for the period October 1, 1987 through December 31, 1990 is measured by:

	Item	State, Local and County
B.	Purchases of catalogs and other non-capital assets from out-of-state retailers or under resale certificates for use in California	$318,566
	Less: Purchases other than catalogs	-106,938
	Disputed Cost of Catalogs	$211,628

Petitioner's Contentions

Petitioner contends, in general, that tax should not apply to catalogs which it purchased outside California, had shipped here and stored for a period of time, and then mailed free of charge directly to prospective customers outside California. Petitioner's detailed arguments are presented and discussed below.

Summary

Petitioner is a publisher and a distributor of books, headquartered in Menlo Park, California.

The Sales and Use Tax Department (Department) audited petitioner. Petitioner purchased catalogs from out-of-state vendors, without tax. The out-of-state printers (vendors) sent some catalogs directly to petitioner's potential customers, and sent others in bulk to petitioner's California facilities where they were stored for future shipment nationwide. The Department assessed use tax on petitioner's cost of catalogs purchased without tax, shipped to California and stored here, and subsequently mailed or delivered free of charge from California to potential customers nationwide.

The Department contends that the first functional use of the catalogs mailed from California occurred in this state. The Department asserts that section 6009.1 of the Revenue and Taxation Code[1] does not apply to exclude petitioner's actions from the statutory definitions of "storage" and "use".

[1]All further statutory references are to the Revenue and Taxation Code.

Petitioner objects to the assessment of tax and has presented several arguments in support of its position. It should be noted that section 6379.5, which provides an exemption for printed sales messages, is not at issue here since petitioner took possession of the catalogs before sending them to prospective customers.

Petitioner's arguments are individually presented and discussed, as follows.

Petitioner's Contention and Summary

1. Petitioner contends that all catalogs were purchased for use in interstate commerce, prior to their entry into California. Once here, the catalogs were distributed nationwide through interstate commerce. Petitioner asserts that mailing is not a "use"; rather, use occurs when catalogs are received by potential customers. However, petitioner agrees that catalogs mailed from California to California destinations are taxable, because then their use (by the recipients) occurs in California.

Petitioner cites Sales and Use Tax Regulation 1620(b)(2)(B)[2], which provides that use tax does not apply to property purchased for use and used in interstate commerce prior to its entry into California, and thereafter used continuously in interstate commerce both within and without California, and not exclusively in California.

The Department's position is that the first functional use of the catalogs occurred in California, and that section 6009.1 does not apply to exclude petitioner's actions from the definitions of "storage" and "use".

Analysis and Conclusion

Section 6201 imposes a tax on the storage, use, or consumption in this state of tangible personal property purchased from any retailer for storage, use, or consumption in this state.

Section 6009 defines a "use" to include the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of that property in the regular course of business. A gift, even temporary in nature such as a loan, is a use inconsistent with holding property exclusively for resale. In Wallace Berrie & Co. v. State Board of Equalization (1985) 40 Cal.3d 60, 68, the court noted that a "[t]ransfer of goods other than by sale in the regular course of business is, almost by definition, a use."

[2]All further references to Regulations are to Sales and Use Tax Regulations.

Section 6009.1, "'Storage' and 'use' - exclusion.", provides as follows:

> "'Storage' and 'use' do not include the keeping, retaining or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state, or for the purpose of being processed, fabricated, or manufactured into, attached to or incorporated into, other tangible personal property to be transported outside the state and thereafter used solely outside the state."

In Parfums-Corday, Inc. v. State Board of Equalization (1986) 187 Cal.App.3d 630, the court noted:

> "The plain meaning of section 6009.1 is clear. There is no taxable use if the property has no function in California other than to move through the state for consumption elsewhere. ... If, however, the property has some `functional purpose' in California other than to serve as a mere object in transit, there is a taxable use. This principle applies even where the property eventually is `substantially consumed in interstate commerce outside of this state'. (American Airlines, Inc. v. State Board of Equalization (1963) 216 Cal.App.2d 180, 192)."

The Department ascribes a "functional use" to petitioner's gifting of the catalogs in California. Sales and Use Tax Annotation 280.0040[3] (10/11/63) provides as follows:

> "Advertising Material -- Gifts. Advertising or promotional material shipped or brought into the state and temporarily stored here prior to shipment outside state is subject to use tax when a gift of the material made (sic) and title passes to the donee in this state. When the donor divests itself of control over the property in this state the gift is regarded as being a taxable use of the property." (10/11/63)

The courts have held that the legislature may delegate authority to administrative boards to adopt and enforce reasonable rules for carrying into effect the expressed purpose of a statute. However, it is equally established that a board or commission may not adopt rules "which abridge, enlarge, extend or modify the statute creating the right." (American Distilling Co. v. State Board of Equalization (1942) 55 Cal.App.2d 799). The Board's interpretations of its regulations are entitled to great weight (American Hospital Supply Corporation v. State Board of Equalization (1985) 169 Cal.App.3d 1088).

[3]All further references to Annotations are to Sales and Use Tax Annotations.

We find that petitioner gifted the catalogs in question at a California location when it withdrew the catalogs from its California warehouse and shipped them to prospective customers by common carrier or U.S. Mail. Petitioner's storage and gifting of the catalogs were the only uses petitioner made of them. The proper focus is on petitioner's use of the catalogs, not that of the donees. No use tax applies to the donees' use, since they did not purchase the catalogs from petitioner. If petitioner had shipped the catalogs, prior to any use, from its California warehouse to its out-of-state warehouse, and then shipped them to prospective customers, section 6009.1 would exclude the purchases from tax since petitioner's sole use in California would have been to store them for subsequent use solely outside the state.

Petitioner contends that the catalogs were not used in California. In order to agree with petitioner, we would have to expand section 6009.1 to include property subjected to some use within California, prior to transporting it outside the state. The reference to a functional purpose in Parfums-Corday, supra, does not exclude gifting, and is not as restrictive as petitioner asserts. Petitioner handled the catalogs first by storing them in its warehouse, and then by withdrawing them from its warehouse gifting them to prospective customers.

Having concluded that the gifting of property is not excluded from the definition of "use" by section 6009.1, a secondary issue as to when and where the gifts occurred needs to be addressed. If petitioner's gifting of the catalogs occurred out-of-state, petitioner made no taxable use of the catalogs in California.

Petitioner brought the catalogs into California, stored them in its warehouse, and then turned them over either to common carriers or the U.S. Mail, with instructions to deliver the catalogs to donees nationwide. Petitioner relinquished all dominion and control over the catalogs when they were turned over to the third party carrier. If delivery, either actual or symbolic, is made to a third person on behalf of the donee, and the donor parts with dominion and control, a gift will be effective (Berl v. Rosenberg (1965) 169 Cal.App.2d 125). All that is necessary to a completed gift is delivery of the property, actual or symbolic, to the donee or to another for his benefit, with the intent to vest title in the donee (White v. Bank of America (1942) 53 Cal.App.2d 831). Petitioner intended its gifts of catalogs to be effective and unconditional when they were placed in the hands of common carriers or the U.S. mail for shipment to donees. The gifts occurred in California, and the use tax is applicable to petitioner's cost of the catalogs.

No adjustment can be recommended based on this contention.

Petitioner's Contention and Summary

2. Petitioner contends that under Regulation 1620(b)(3), the first functional use of the catalogs is mail order distribution through interstate commerce. Petitioner asserts that the first functional use of the catalogs was also made outside California, and the catalogs were subsequently brought to this state approximately 90 days after the date of purchase. Petitioner argues that according to the Regulation, "functional use" means use for the purpose for which the property was designed, and that prior out-of-state use exceeding 90 days from the date of purchase to the date of entry into California should be accepted as proof of intent that the catalogs were not purchased for use in California.

Petitioner contends that the first functional use of the catalogs is receipt by the donees, and considers "use" to be the intent to generate out-of-state sales. The Department asserts that the first functional use occurs when petitioner makes a gift of the catalogs and places them in the mail in California.

Analysis and Conclusions

Based on the Analysis and Conclusions for the first contention, it is clear that petitioner gifted the catalogs in California by shipping them to recipients free of charge.

Petitioner argues that the catalogs were used out-of-state more than 90 days prior to their entry into California, making them exempt under Regulation 1620(b)(3). However, that regulation, by definition, states that the 90 day rule applies when the property is first functionally used outside California. In this case, the petitioner first functionally used the catalogs when they were gifted to donees. Petitioner made only two uses, storage and gifting, and both occurred in California. Regulation 1620 defines "functional use" to mean use for the purposes for which the property was designed. Petitioner had no use for the catalogs other than to distribute them to prospective customers.

The first functional use of the catalogs occurred in California, there is no taxable use by donees, and there was no prior out-of-state use by petitioner.

No adjustment can be recommended based on this contention.

Petitioner's Contention and Summary

3. Petitioner states that section 6010.5, "Place of Sale", provides that the place of sale is where the property is physically located at the time the act constituting the sale takes place. Petitioner asserts that sales occurred at locations outside California when catalogs were used by out-of-state customers to place orders for merchandise with petitioner. Therefore, sales were transacted at out-of-state locations through the use of the catalogs by petitioner's customers.

The Department contends that the catalog printer made sales of catalogs to petitioner, and that the place of sale is where the catalogs were located at the time the sales between petitioner and the catalog printer took place, outside California. The Department states that the place of sale is immaterial, because the taxable event is use of the catalogs by petitioner in California.

Analysis and Conclusions

Refer to the Analysis and Conclusions section for the first contention, wherein the issue of catalog usage was addressed.

Petitioner's use of the catalogs in California is being taxed. The place of sale of the items advertised in the catalogs is irrelevant.

No adjustment can be recommended based on this contention.

Petitioner's Contention and Summary

4. Petitioner cites two recent cases from other states in support of its position that use occurs, and use tax is due, at the final destinations of the catalogs. Petitioner does not dispute that tax is due on catalogs sent to California customers from California.

In D.H. Holmes Company, Ltd. v. Shirley McNamara, Secretary of Revenue and Taxation of Louisiana (1988) 486 U.S. 24, it was decided that Louisiana use tax imposed on catalogs printed out-of-state and shipped to prospective customers in-state did not violate the Federal Constitution's Commerce Clause. A Louisiana corporation with its principal place of business, and some department stores, in Louisiana had catalogs printed out-of-state and mailed directly from the printer to Louisiana residents. The court found that it was "largely irrelevant" for Commerce Clause purposes whether the catalogs "came to rest" in the Louisiana customers' mailboxes, or whether they were still considered as being in the stream of interstate commerce, since in Complete Auto Transit v. Brady (1977) 430 U.S. 274 it was recognized that, with certain restrictions, interstate commerce may be required to pay its fair share of taxes[4]. Moreover, the court found no merit in the argument that the tax assessment was in essence a tax on the mere presence of goods within the state, since distribution constitutes a use under the applicable statute. The court found that the tax assessment satisfied all parts of the Complete Auto Transit test.

[4]In Complete Auto Transit, the U.S. Supreme Court held that a Mississippi tax on the privilege of doing business in the state did not violate the Commerce Clause when the tax:

1. is applied to an interstate activity with a substantial nexus with the taxing state;
2. is fairly apportioned to local activities;
3. does not discriminate against interstate commerce; and
4. is fairly related to the services provided by the taxing state to the taxpayer.

The second case cited by petitioner, J.C. Penney Co., Inc. v. Martha B. Olsen, Commissioner of Revenue, State of Tennessee (1990) 796 S.W.2d 943, upheld a Tennessee use tax assessment on merchandise catalogs printed out-of-state and sent directly to Tennessee residents. Quoting Woods v. M.J. Kelley Co. 592 S.W.2d 567 (Tennessee, 1980), the court commented "... Thus, it was the legislative intent, as manifested in (Tennessee statutes), to impose a use tax on all tangible personal property imported from other states and used and consumed in this State, provided a similar tax, equal to or greater, has not been paid in the exporting state." The court noted that the evidence proved that J.C. Penney did use the catalogs for its own benefit, although the title and possession of them may have been in the recipients in Tennessee. The Tennessee scheme of taxation was found to encompass more than simple title to and possession of tangible property. Rather, the taxable privilege of use was found to extend to the utilization of property for profit making purposes. The court held that the trial court was correct in finding that J.C. Penney exercised a taxable use with respect to the catalogs printed outside of Tennessee and shipped to Tennessee addresses.

Analysis and Conclusions

Neither of these cases support petitioner's contention that California use tax does not apply to catalogs which the petitioner, not the catalog printer, sent free of charge from California to out-of-state recipients. Both cited cases are distinguishable, because they involve use tax assessed against purchasers on catalogs purchased out-of-state, and shipped directly from the printers to recipients located in the purchasers' states (Louisiana and Tennessee). In both cases, the purchasers never took physical possession of their catalogs, yet the courts upheld the use tax assessments. By contrast, in this case the purchaser had the printer ship the catalogs to its California warehouse, in bulk, for later distribution by petitioner.

No adjustment can be recommended based on this contention.

Petitioner's Contention and Summary

5. Petitioner contends that Complete Auto Transit v. Brady, supra, compels that taxing petitioner's interstate shipments of catalogs violates the Commerce Clause. Petitioner asserts that tax cannot be imposed on the catalogs without consideration of their final resting place, or the relative value of the business generated by the catalogs within the various states (the majority of petitioner's mail order business comes from outside California, and the majority of the catalogs at issue here are sent to states other than California). Petitioner believes that the catalogs in question cannot be taxed because they were purchased for use in interstate commerce, and were continuously used in interstate commerce. Regarding the four part test in Complete Auto Transit (see footnote 4), petitioner argues that:

a) The tax is not fairly apportioned, because all catalogs are taxed regardless of the amount of sales generated in the various states.

b) The California tax assessment discriminates against interstate commerce, and does not allow a free flow of goods through interstate commerce.

c) The California tax assessment does not relate to state-provided services that facilitate the taxpayer's in-state sales.

d) Petitioner does not contest that it has sufficient nexus in California.

The Department contends that there is no "nexus" issue in this case, and that tax applies to petitioner's use of the catalogs in California, regardless of where the catalogs generate sales. The Department contends that there is no discrimination in this case, because the tax rates applied are the same as they would be if petitioner purchased the catalogs from in-state printers.

Analysis and Conclusion

Petitioner's arguments in (a), (b), and (c), above, are addressed as follows.

Petitioner argues that the tax is not fairly apportioned. However, tax has been assessed on a use that occurred in California (see 1., supra), and provisions exist (e.g., section 6406) that prevent the taxes imposed from being duplicated by the taxes of other states. It is petitioner's use of the catalogs in California that justifies the imposition of use tax, and the amount of sales generated by the catalogs in other states is irrelevant to fair apportionment. No attempt has been made to tax any of petitioner's uses of tangible property outside California. The tax is, therefore, fairly apportioned to petitioner's California activities.

Petitioner argues that the taxes imposed discriminate against interstate commerce. However, the use tax assessed against the catalogs places no greater burden upon interstate commerce than is placed upon competing intrastate commerce of like character. If petitioner purchased catalogs from a California printer, and used them alongside the catalogs at issue in this appeal, either sales or use tax, but not both, would apply to the catalogs purchased in California, at the same rate applied to the out-of-state purchases. Based on the foregoing, the taxes at issue in this appeal do not discriminate against interstate commerce.

Petitioner contends that the taxes assessed do not relate to state-provided services that facilitate the taxpayer's in-state sales. Petitioner is headquartered in Menlo Park, California, and maintains a California warehouse from which catalogs are shipped to recipients nationwide. Petitioner has the benefit of local services such as police and fire protection, streets, utilities, municipal facilities, and other services. California has provided benefits and protections to petitioner for which it is justified in asking a fair and reasonable return.

I conclude that the use taxes at issue in this appeal do not violate the Commerce Clause because petitioner's activities have a sufficient nexus with California, the tax is fairly apportioned to petitioner's local activities, the tax does not discriminate against interstate commerce, and the tax is fairly related to benefits provided by the state.

Even if I were to agree that the imposition of use tax would be unconstitutional in this case, the Board is precluded from declaring it as such by Article III, Section 3.5 of the California Constitution. State agencies do not have the power to declare a state statute unconstitutional. Those powers are reserved to the courts.

Accordingly, no adjustment can be recommended based on this contention.

Petitioner's Contention and Summary

6. Petitioner is concerned that if the National Bellas Hess case is overturned by Congress, the imposition of California use tax on its catalogs raises a significant risk of double taxation.

At the Appeals conference, petitioner noted that recent court decisions have reduced the risk of double taxation to some degree. However, petitioner expressed concern that if, for example, California use taxes were assessed on catalogs mailed from its California warehouse to Tennessee recipients, then under J.C. Penney, supra, Tennessee tax would also apply, and the catalogs would be subject to double taxation.

The Department contends that this is not an issue, and that a section 6406 credit is allowed in California for taxes paid to other states on property used here.

Analysis and Conclusions

Under section 6406, petitioner is allowed a tax credit if, for instance, sales or use taxes are imposed by the state where catalogs are printed, and California use tax is subsequently assessed (e.g., in a Department audit) when the catalogs are used in California. In addition, under Complete Auto Transit, supra, the tax must be fairly apportioned, meaning that to avoid double taxation the taxing scheme must provide a credit against the use tax assessed for taxes imposed by other states.

The risk of double taxation is not an issue here, because the State of California is not attempting to assess a double tax on petitioner. The Department's use tax assessment on petitioner's catalogs will not result in double taxation because, under section 6406, a credit against the California tax will be allowed for sales/use taxes previously paid on the catalogs to other states. The states where catalogs are sent are required, under Complete Auto Transit, supra, to fairly apportion any use tax applicable to the catalogs to local activities, and to not assess taxes that are duplicative of those assessed by other states.

Accordingly, no adjustment can be recommended based on this contention.

Recommendation

Redetermine without adjustment.

John Frankot, Staff Counsel Date