

STATE OF CALIFORNIA
 BOARD OF EQUALIZATION
 BUSINESS TAXES APPEALS REVIEW SECTION

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

The Appeals Conference in the above-referenced matter was held by Senior Staff Counsel H. L. Cohen on September 22, 1992, in San Francisco, California.

Appearing for Petitioner:

Mr. [W]
 Attorney at Law

Appearing for the
 Sales and Use Tax Department:

Mr. B. Hitchcock
 Supervising Tax Auditor
 San Francisco District

Protested Items

The protested tax liability for the period August 1, 1985 through March 31, 1989 is measured by:

	<u>Item</u>	<u>State, Local and County</u>
A.	Sales of books and printed matter based on sales records	\$35,143,796
B.	Additional sales of books and printed matter based on financial reports	3,001,596
C.	Taxable portion of charges for postage and handling	3,011,138
D.	Cost of premiums given to teachers	<u>584,288</u>
	TOTAL	\$41,740,818

Contentions

Petitioner contends that:

1. Petitioner has no nexus with the state and cannot be required to collect use tax from its California customers.
2. The transfers of premiums to teachers in exchange for "bonus points" are not sales.
3. The charges for transportation are separately stated and thus not subject to tax.
4. Relief should be granted from the penalty for failure to file returns.

Summary

Petitioner is a partnership which is engaged, among other activities, in selling books and printed materials by direct mail solicitation. It also sells book through arrangements with teachers within California. There has been no prior Board audit.

Petitioner sends materials through the mail to teachers to encourage them to participate in petitioner's program for the sale of children's books. A teacher who wishes to encourage his or her students to read through participation in a book club and who selects petitioner's club passes out to the students promotional material furnished by petitioner. The students take the materials home and, together with their parents, select the books they wish to purchase. The students bring order forms and payment back to the classroom. The teacher consolidates the orders and sends the orders and payment to petitioner. Petitioner ships the books to the teachers who distribute them to the students.

Petitioner awards bonus points to the teachers based on the volume of orders. Teachers can use the bonus points to order gifts from a catalog. Some of the gifts ordered are items for classroom use. Others are for the teacher's use at home. Petitioner states that the types of gifts ordered indicates that the teachers do not as a rule participate in petitioner's program for personal gain.

The auditor regarded the participating teachers as agents of petitioner for the purpose of making sales in California. The auditor concluded that this use of agents in California establishes nexus between petitioner and the state, thus giving the state the power to require petitioner to collect use tax from its customers and making petitioner liable for the amount of use tax which should have been collected. The auditor cited as support for this position Scholastic Book Clubs, Inc. v. State Board of Equalization, 207 Cal.App.3d 734.

The auditor examined petitioner's sales records of book sales to California customers and applied tax to the total recorded sales. (Audit Item A.) The California sales varied between seven percent and nine percent of petitioner's total sales. The auditor also examined petitioner's financial statements and found that sales as shown in the financial statements exceeded those shown on petitioner's sales records. The auditor applied tax to the difference based on the observed percentage of California sales to total sales. (Audit Item B.)

The auditor examined petitioner's charges for postage and handling on sales to California customers. The auditor concluded that handling charges were about 40 percent of total postage and handling charges. Accordingly, tax was applied to 40 percent of those charges. (Audit Item C.) Subsequently, the auditor reconsidered this item. The auditor concluded that books sent through the mail are frequently sent by fourth class mail. Packages sent by fourth class mail do not show the amount of postage paid with respect to individual packages. The auditor concluded that only 7.3 percent of the postage and handling charges represented postage charges in which the amount of postage actually appeared on individual packages. The auditor applied additional tax on postage and handling charges in an audit report dated February 14, 1992. Audit Item C was increased by \$3,967,174 to \$6,978,312. The auditor based the change on Business Taxes Law Guide (BTLG) Annotation 557.0450 (9/16/74).

The auditor regarded the transfer of premiums from petitioner to teachers as sales in exchange for the bonus points. Tax was applied based on the cost of the premiums to petitioner. (Audit Item D.) The auditor relied for support on this issue on BTLG Annotations 280.0740 (8/31/55) and 295.1040 (9/8/69).

Petitioner contends that its activities in California can be distinguished from those of the teachers in the Scholastic Book Clubs case who were found to be agents of the out-of-state seller. Petitioner argues that in petitioner's situation, the teachers are acting as teachers, not as petitioner's sales agents. In addition, only about four percent of petitioner's sales to California customers are made through its book club activities, whereas a large percentage of Scholastic's sales may have been made through book clubs. Petitioner argues that it cannot be required to collect use tax because it has no nexus with the state.

Petitioner contends that under Sales and Use Tax Regulation 1628, tax cannot be applied to its charges for postage. The regulation must take precedent over the annotation cited by the auditor. Postage charges should not be subject to tax regardless of whether or not the amount of postage is shown on the package.

Petitioner contends that the premiums transferred to the teachers are not equivalent to commissions. Almost all of the premiums are of token value and are intended for use in the classroom. They are not intended to supplement the teachers' incomes, as would commissions.

Petitioner submitted a request signed under penalty of perjury for relief from the penalty for failure to file returns. The basis for the request is the petitioner believed in good faith that it had no nexus with the State of California and was not required to collect the use tax from its California customers. The auditor recommended that the relief be granted.

Analysis and ConclusionsNexus

Section 6203 of the Revenue and Taxation Code requires retailers engaged in business in California to collect the use tax from California customers. Section 6204 provides that the retailers who are engaged in business in this state are liable to the Board for any amounts of use tax which they are required to collect whether or not they do in fact collect the amounts from the California customers. Section 6203 defines "retailer engaged in business in this state" to include any retailer having any representative, agent, salesman, canvasser, or solicitor operating in this state under the authority of the retailer for the purpose of selling, delivering, or the taking of orders for any tangible personal property. Retailers engaged in business in this state are responsible to the Board for the use tax on merchandise sold by mail order as well as merchandise sold directly through agents. See People v. West Publishing Company 35 Cal.2d 80, and National Geographic Society v. California Board of Equalization, 430 U.S. 551.

There is no constitutional issue present in this audit. If the teachers are agents of petitioner, the cited courts cases support the imposition of the tax collection duty on petitioner. If the teachers are not petitioner's agents, there is no nexus and petitioner cannot be required to collect the tax.

Agency

In order to determine whether the teachers dealing with petitioner are petitioner's agents, we look solely to the definition of "retailer engaged in business in this state" cited above. The teachers represent petitioner to the students. The teachers participate in making the sales. They operate under the petitioner's authority in that they are authorized to take orders, collect payment, and make deliveries of the merchandise. The use of school organizations to perform the identical activities was regarded as the establishment of an agency relationship in the Scholastic Book Clubs, Inc. case cited above. More recently, in a similar case, the Board prevailed at the trial court level. That case Educational Reading Service Book Fairs, Inc. v. State Board of Equalization, San Francisco Sup. Ct. No. 873988. The plaintiff has appealed in that case.

In summary, there is ample basis for finding that the teachers are petitioner's agents and that petitioner therefore is engaged in business in this state. By being engaged in business in this state, petitioner is required to collect the use tax on all sales to California customers.

Postage

Section 6011 defines "sales price", which is the amount subject to the use tax, to exclude, under certain conditions, separately stated charges for transportation from the retailer's place of business or point from which shipment is made directly to the purchaser. Regulation 1628, which interprets this statute, provides in the pertinent part of subdivision (a):

"Transportation charges will be regarded as 'separately stated' only if they are separately set forth in the contract for sale or in a document reflecting that contract, issued contemporaneously with the sale, such as the retailer's invoice. The fact that the transportation charges can be computed from the information contained on the

face of the invoice or other document will not suffice as a separate statement. If a separately stated charge is made designated ‘postage and handling’ only that portion of the charge which represents actual postage may be excluded from the measure of tax.”

Clearly, handling charges are taxable as services related to the sale of tangible personal property. Charges for “postage and handling” are taxable in their entirety if it cannot be determined what part of the charge is for postage. It is not sufficient that the amount of postage can be determined from information in petitioner’s possession. The concept of a separately stated charge implies that the buyer is notified what that charge is. In a case of delivery by mail, the buyer will effectively be notified if the postage is affixed to the package. When the portion of the regulation quoted above is read together with the statute, it is clear that postage may be excluded from the amount subject to tax only if the postage is affixed to the package. That is the basis for Annotation 557.0450 which was cited by the auditor. Accordingly, the auditor’s approach is correct. I note also that in this case, the property is shipped to the teachers, not directly to the buyers.

Premiums

Section 6006 defines “sale” and Section 6010 defines “purchase” to include the transfer of title to tangible personal property for a consideration. Petitioner transfers tangible personal property to the teachers. The consideration from the teachers consists of bonus points which they earned by acting as agents of petitioner. The type of premium selected and the motivation for selecting a specific premium are irrelevant in terms of the definition of “sale” and “purchase”. Annotations 280.0740 and 295.1040, which the auditor cited, support this position. The remaining question is only the valuation of the consideration. Since the bonus points have no cash value, the auditor’s use of petitioner’s cost is justified.

Recommendation

Grant relief from the penalty for failure to file returns. Redetermine otherwise in accordance with the reaudit report dated February 14, 1992.

H. L. Cohen, Senior Staff Counsel

1-19-92

Date