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March 28, 2002

Ms. S--- L. S---  
--- --- LLP  
XXX --- Street, Suite XXXX  
--- ---, California XXXXX-XXXX

Re: M--- M--- International SR --- XX-XXXXXX  
I--- D--- T--- SR --- XX-XXXXXX

Dear Ms. S---:

This responds to your letter of November 18, 2001. You requested that we reconsider the opinions expressed in my memorandum of August 29, 2001 to Vic Anderson of this agency regarding certain transactions involving your clients, identified above. I apologize for the delay in responding. Copies of your November 19, 2001 letter and my August 29, 2001 memorandum are attached hereto.

Your disagreement with my opinion was with respect to your client's gift of promotional pens. You explained:

"IDT is a manufacturer and retailer of pens with its principal place of business in California. To promote sales, IDT arranges for sample pens to be given away to prospective customers located within and outside California.

"P--- N---, S.A. DE C.V. (P---), a separate legal entity affiliated with IDT, is a maquiladora located in Mexico. [ ] IDT arranges for unfinished pens to be delivered to P--- in Mexico for final assembly and processing. In addition to providing final processing, P--- acts as a mailing house and forwarding agent for IDT. P--- fulfills its obligations as forwarding agent in two ways.

“(1) By arranging for a common carrier to deliver promotional pens from Mexico for delivery through the United States Postal Service (USPS) to beneficial donees.

“(2) By delivering promotional pens from Mexico in its own trucks for delivery through the USPS to beneficial donees.

“The August 29<sup>th</sup> memorandum distinguishes between these two methods of delivery in determining where a gift is complete. With regard to deliveries by common carrier, the memorandum finds that IDT completes a gift outside California (i.e. in Mexico). With regard to deliveries by P---, the memorandum finds that IDT completes a gift inside California (i.e. at the USPS in San Diego.)

“IDT respectfully requests that the findings with regard to deliveries by P--- be reconsidered and revised for two reasons. First, the controlling authorities for determining when a gift is complete do not provide any basis for distinguishing between deliveries by common carrier and deliveries by P---, under IDT’s facts and circumstances. The controlling authorities look to where the donor divests control. As explained below, IDT divests control over the pens in Mexico in both cases such that a gift is completed in Mexico.

“Second, the promotional pens begin a journey in foreign commerce in Mexico with delivery to the USPS in San Diego merely being an incidental step to completing the journey. Accordingly, delivery to the USPS in San Diego for redelivery to beneficial donees is exempt from use tax pursuant to Regulation 1620, Interstate and Foreign Commerce.”

#### Discussion:

After reconsidering your client’s activities, we are still of the opinion that pens driven in P--- trucks by P--- employees from Mexico into California, where they are delivered to the United States Postal Service (“USPS”), are used in California, and use tax applies to IDT’s gifts of such property.

You asserted that the decision in *Yamaha Corp. of American v. State Board of Equalization* (1999) 73 Cal. App. 4<sup>th</sup> 338 (“*Yamaha*”) and the decision of the Board of Equalization in its *Hewlett Packard Company* Memorandum Opinion of June 15, 2000 (“*H-P*”) compel a different result. We disagree.

As applied to IDT, *Yamaha* holds that IDT divested itself of control over the property in California, when the P--- driver, as IDT’s agent in the affiliated capacity, delivered the pens to the USPS in California. That the driver had limited authority does not change the fact that the driver is employed by P---, an affiliate of IDT, and that title never transfers from IDT until

delivery of the pens to the USPS in California. The pens are effectively in the control of IDT until the USPS receives possession.

We also disagree that the *H-P* Memorandum Opinion requires a different result. The facts described in the opinion are very specific, and the decision in *Yamaha* is carefully distinguished. In *H-P*, in addition to other factors, the donor entered into prior written agreements with the donees, which expressly stated that title to the gifted property would not pass until delivery by the carrier to the donee. We do not see such a title provision in IDT's case, and in fact none could really exist, as the donees of the pens receive them as unanticipated promotional marketing material. For these reasons, we believe the *Yamaha* decision and the *H-P* Memorandum opinion compel a conclusion that use tax applies when IDT's pens are delivered to the USPS in California.

You also assert that Regulation 1620 compels a different result than the opinion in my August 29, 2001 memorandum, and you cited Annotation 570.1110 (11/28/66) in support of your position. Please note that Annotation 570.1110 was removed from the Business Taxes Law Guide because the back-up letter was found to have been inaccurate. With respect to Regulation 1620, no portion of subdivision (a) applies to these facts, because the pens are not sold in a sales tax transaction in interstate commerce. You asserted that pens had entered the stream of foreign commerce, and found support in Regulation 1620 (a)(3)(C)2.c. You further asserted that while subdivision (a) of Regulation 1620 addresses sales tax issues, the same standard must "apply for determining when property has entered the stream of foreign commerce for use tax purposes." We disagree.

Sales tax applies to the gross receipts from the retail sale of tangible personal property in this state. (Rev. & Tax. Code, §6051.) We are concerned instead with whether the use tax applies to IDT's use of the pens in this state. (Rev. & Tax. Code, §6201.). Regulation 1620 (a)(3)(C)2 explains the conditions when sales tax does not apply to property exported to a foreign country. One of the conditions, set forth in the first full paragraph of the subdivision, is that the property "must be irrevocably committed to the exportation process at the time of sale...." The other condition, however, is that the property "must actually be delivered to the foreign country prior to any use of the property." Because we have concluded that the gift occurred when the P--- driver delivered the pens to the USPS, then the use did in fact occur in California. Even if you could argue that the standard set forth in the sales tax provision of Regulation 1620(a) somehow applied here, the argument would fail, because the use of the pens occurred in California before they left the state.

Because the gifting of pens is a use tax transaction, it is our opinion that subdivisions (b)(1) and (b)(5) of Regulation 1620 plainly establish that the use occurs in California, in the form of gifts, and such use is taxable. Subdivision (b)(1) states essentially the same use tax rule found in Revenue and Taxation Code section 6201. Subdivision (b)(5) states in full:

"(b)(5) IMPORTS. Use tax applies with respect to purchases of property imported into this state from another country when the use occurs after the

process of importation has ceased and when sales tax is not applicable, regardless of whether the property is in its original package.”

It is our opinion that under the facts here, the process of importation ceases when the P--- driver arrives at his destination in California, and the use occurs when the driver delivers the pens to the USPS, making the gift complete.

For all of these reasons, we have concluded that the opinions stated in my August 29, 2001 memorandum correctly state the application of tax to your client’s transactions. If you have further questions, please write again.

Sincerely,

Jeffrey H. Graybill  
Senior Tax Counsel

JHG/ds  
Enclosures

cc: San Diego District Administrator (FH)