

**Text of Proposed Amendments to
California Code of Regulations Title 18,
Section 1706, Drop Shipments**

Regulation 1706. Drop Shipments.

(a) Definitions. For purposes of this regulation:

~~(1) “Retailer engaged in business in this state” means and includes any person who would be so defined by Revenue and Taxation Code section 6203 if the person were a retailer.~~

~~(2) “True retailer” means and includes a retailer who is not a retailer engaged in business in this state and who makes a sale of tangible personal property to a consumer in California.~~

~~(3) “Drop shipment” means and includes any delivery of tangible personal property by an owner or former owner thereof, or factor or agent of that owner or former owner, to a California consumer pursuant to the instructions of a true retailer.~~

~~(4) “Drop shipper” means and includes any owner or former owner of tangible personal property thereof, or factor or agent of that owner or former owner, who makes a drop shipment of tangible personal property.~~

~~(5) “Marketplace” means and includes any place that would be so defined by Revenue and Taxation Code section 6041.~~

~~(6) “Marketplace facilitator” means and includes any person that would be so defined by Revenue and Taxation Code section 6041.~~

~~(7) “Marketplace seller” means and includes any person that would be so defined by Revenue and Taxation Code section 6041.~~

~~(8) “Retailer engaged in business in this state” means and includes any person who would be so defined by Revenue and Taxation Code section 6203 if the person were a retailer.~~

~~(9) “True retailer” means and includes any retailer who is not a retailer engaged in business in this state and who makes a sale of tangible personal property to a consumer in California.~~

(b) General. A drop shipment generally involves two separate sales. The true retailer contracts to sell tangible personal property to a consumer. The true retailer then contracts to purchase that property from a supplier and instructs that supplier to ship the property directly to the consumer. The supplier is a drop shipper. A drop shipper that is a retailer engaged in business in this state is

reclassified as the retailer and is liable for tax as provided in this regulation. When more than two separate sales are involved, the person liable for the applicable tax as the drop shipper is the first person who is a retailer engaged in business in this state in the series of transactions beginning with the purchase by the true retailer.

(c) Marketplace sales. When a marketplace facilitator is the retailer for a retail sale of tangible personal property to a California consumer by a marketplace seller under Revenue and Taxation Code section 6043, the marketplace facilitator is not a true retailer. In addition, if the marketplace seller contracts to purchase the property from a supplier and instructs the supplier to deliver the property directly to the consumer, the supplier is not a drop shipper. See Regulation 1684.5, *Marketplace Sales*, for more information about how to determine who the retailer is for purposes of a marketplace sale.

(de) Application of tax.

(1) Unless the sale to the California consumer and the use by the California consumer are exempt from sales and use tax as otherwise provided in the Sales and Use Tax Law, a drop shipper must report and pay tax measured by the retail selling price of the property paid by the California consumer to the true retailer.

(2) Except as provided in subdivision (de)(3) of this regulation, for reporting periods commencing on or after January 1, 2001, ~~at~~ the drop shipper may calculate the retail selling price of its drop shipments of property based on its selling price of the property to the true retailer plus a mark-up of 10 percent (10%). A drop shipper may use a mark-up percentage lower than 10 percent if the drop shipper can document that the lower mark-up percentage accurately reflects the retail selling price charged by the true retailer to the California consumer.

If a mark-up percentage lower than 10 percent is developed in an audit of the drop shipper, the drop shipper may use that percentage for the subsequent reporting periods provided the drop shipper has not had a significant change in business operations. Provided there is no significant change in business operations, if a later audit develops a higher percentage, the ~~Board~~Department would not assess additional tax based on that newly computed mark-up percentage. However, for subsequent reporting periods, the lower mark-up from the previous audit cannot be used, and the drop shipper must instead use the higher percentage developed in the most recent audit or 10 percent, whichever is lower.

(3) The procedures set forth in subdivision (de)(2) of this regulation do not apply to drop shipments of vehicles, vessels, and aircraft (also known as “courtesy deliveries”). For purposes of this regulation, “vehicle,” “vessel,” and “aircraft” are defined in ~~Sections 6272,~~

~~6273, and 6274~~ of the Revenue and Taxation Code sections 6272, 6273, and 6274, respectively.

(e) Examples.

(1) ABC Co. is not a retailer engaged in business in this state. It contracts to sell tangible personal property to a California consumer. ABC Co. then contracts with XYZ Inc. to purchase the tangible personal property. ABC Co. instructs XYZ Inc. to ship the property directly to the California consumer. XYZ Inc. is a retailer engaged in business in this state. XYZ Inc. is the drop shipper liable for the applicable tax as the retailer.

(2) ABC Co. is not a retailer engaged in business in this state. It contracts to sell tangible personal property to a California consumer. ABC Co. then contracts with XYZ Inc. to purchase the tangible personal property. ABC Co. instructs XYZ Inc. to ship the property directly to the California consumer. XYZ Inc. is a retailer engaged in business in California. XYZ Inc. then contracts with Supplies Corp. to purchase the tangible personal property, and instructs Supplies Corp. to ship the property directly to the California consumer. Whether or not Supplies Corp. is a retailer engaged in business in this state, XYZ Inc. is the drop shipper liable for the applicable tax as the retailer.

(3) ABC Co. is not a retailer engaged in business in this state. It contracts to sell tangible personal property to a California consumer. ABC Co. then contracts with XYZ Inc. to purchase the tangible personal property. ABC Co. instructs XYZ Inc. to ship the property directly to the California consumer. XYZ Inc. is not a retailer engaged in business in this state. XYZ Inc. then contracts with Supplies Corp. to purchase the tangible personal property, and instructs Supplies Corp. to ship the property directly to the California consumer. Supplies Corp. is a retailer engaged in business in this state. Supplies Corp. is the drop shipper liable for the applicable tax as the retailer.

(4) Dropshipper Company is a drop shipper of tangible personal property to California consumers on behalf of retailers who are not retailers engaged in business in this state. During its last audit, the ~~Board~~Department developed and applied a mark-up of 8½ percent. During the current audit, the ~~Board~~Department develops a mark-up of 11 percent. The ~~Board~~Department will apply a mark-up of 8½ percent in the current audit provided there was no significant change in Dropshipper Company's business operations between the prior audit period and the current audit period. If there was a significant change in business operations, the ~~Board~~Department will apply a mark-up percentage of 10 percent in the current audit. For periods after the current audit period, Dropshipper Company must use a 10 percent mark-up percentage.

(5) In the previous example, Dropshipper Company sold only ~~computer hardware~~furniture during the period covered by the prior audit, but in the period covered by the current audit, it also made considerable sales of ~~computer software~~appliances. Since there was a significant change in Dropshipper Company's business operations after the prior audit period, the mark-up of 8½ percent developed during that audit does not apply. The ~~Board~~Department will apply a mark-up of 10 percent (because it is lower than the 11 percent mark-up developed during the audit).

(6) ABC Co. is a marketplace seller and not a retailer engaged in business in this state. On December 1, 2019, a marketplace facilitator that is registered with the Department for a seller's permit or Certificate of Registration – Use Tax facilitates a retail sale of tangible personal property to a California consumer by ABC Co. through its online marketplace. ABC Co. then contracts with XYZ Inc. to purchase the tangible personal property and instructs XYZ Inc. to ship the property directly to the California consumer. XYZ Inc. is not a drop shipper liable for the applicable tax as the retailer. The marketplace facilitator is the retailer and is liable for the applicable tax.

(f) Burden of proof.

(1) An owner or former owner of tangible personal property, or a factor or agent of that owner or former owner, who, upon the instructions of that person's customer, delivers property to a person in California~~consumer~~ is presumed to be a drop shipper liable for the applicable tax as the retailer.

(1) A person may overcome ~~this~~the presumption by accepting a timely resale certificate in good faith from that person's customer that ~~includes~~contains all the essential elements as provided by Regulation 1668, Sales for Resale, including:~~a valid California seller's permit number. The acceptance of a resale certificate that does not include a valid California seller's permit number will not overcome the presumption.~~

(A) The customer's valid California seller's permit number; or

(B) An explanation as to the reason why the customer is not required to hold a California seller's permit, and:

1. A statement that the customer is registered with the Department for a Certificate of Registration – Use Tax and the customer's valid Certificate of Registration – Use Tax account number; or

2. A statement that the customer is a marketplace seller and purchasing the property pursuant to a sale facilitated by a registered marketplace facilitator that is the retailer

for purposes of the sale, and the marketplace facilitator's name and valid seller's permit number or Certificate of Registration – Use Tax account number.

(2) A person who does not timely obtain a resale certificate from the person's customer that satisfies the requirements of subdivision (f)(1) may overcome the presumption by establishing that the person's customer was a retailer engaged in business in this state at the time of the sale or the person's customer was a marketplace seller and purchased the property pursuant to its sale facilitated by a marketplace facilitator that was the retailer for purposes of the sale.

(32) A person ~~otherwise qualifying as a drop shipper under this regulation~~ can also overcome the presumption ~~that the delivery is to a consumer~~ by accepting a timely and valid resale certificate in good faith that contains all the essential elements as provided by Regulation 1668 from the person in California to whom the property is delivered.

Note: Authority cited: Section 7051, Revenue and Taxation Code-, Sections 15570.22 and 15570.24, Government Code. Reference: Sections 6007,6041, 6043, 6091, and 6203, Revenue and Taxation Code.