

Due to state regulations monitoring the purchase, sale, and movement of **** and **** in the US, both ***** Y and ***** A are generally required to record purchases and receipts of ***** ***** in the ultimate destination states. Therefore, ***** Y knows the ultimate destination (the location of the respective ***** A division placing the order) of the specific products at the inception of shipping of those products, and tracks and bills each shipment as such. Product which is billed and intended for a specific division of ***** A at the inception of shipping is never deviated to another division of ***** A.

The consolidated orders received at the 3PL are packed and shipped in the same form they were received. Product is received in pallets of ** to ** **** per pallet. Product will remain at the 3PL for an average of ** days, depending on the inventory flow at a particular ***** A division location, before they are sent to the ultimate state destination warehouse. While the **** may be moved from one pallet to another, there is no unpacking and/or repackaging of the **** received in the pallets. The product arrives by the *** on pallets and is subsequently shipped by the *** on pallets.

ISSUE

Whether sales of **** and *** ultimately destined for another state but shipped to a third party public warehouse in California for temporary storage pending shipment in the same form as received to the ultimate destination state are considered sales within California pursuant to Revenue and Taxation Code section 25135.

HOLDING

Such sales do not constitute sales within California pursuant to Revenue and Taxation Code section 25135.

DISCUSSION

Revenue and Taxation Code section 25135 provides in pertinent part:

- (a) Sales of tangible personal property are in this state if:
- (1) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale.
 - (2) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (A) the purchaser is the United States government or (B) the taxpayer is not taxable in the state of the purchaser.

In *McDonnell Douglas Corporation v. Franchise Tax Board* (1994) 26 Cal.App.4th 1789, the appellant manufactured commercial and military aircraft and aircraft parts. It owned a facility in Long Beach, California and the majority of its commercial aircraft were delivered to

customers at that facility or at a facility in Arizona. Customers then arranged for transportation of the aircraft to their ultimate destination. At issue was whether aircraft manufactured for use out of California, but delivered to the purchaser in California constituted California sales as defined by Revenue and Taxation Code section 25135, subdivision (a). The court held that the phrase "within this state" modified the word "purchaser" and therefore, the sales should be apportioned to the state of destination rather than the state of delivery. The court found that including these sales in the California sales factor numerator regardless of the ultimate destination was contrary to the rules adopted by other states and contrary to the purpose of UDITPA.

The Board of Equalization subsequently issued its decision in *Appeal of Mazda Motors* (1994) 94-SBE-009 on November 29, 1994. In *Mazda Motors*, the appellant imported vehicles from Japan for sale in the United States to its regional distributors. The vehicles and parts at issue entered the U.S. through two ports of entry in California. Some of the vehicles were transferred directly to Texas via common carrier after being off-loaded from the ships. These sales were not included in the California numerator. However, other vehicles were stored in California while accessories were being installed, repairs were being made or other services were being performed by appellant and which appellant subsequently shipped pursuant to the distributor's directions. The Board of Equalization concluded that the sales of those vehicles were in this state because the activity of appellant on the purchaser's behalf, which included storing and adding accessories to the vehicles, had caused shipment to terminate in this state. The Board of Equalization noted that the activities by the appellant, on behalf of the purchaser, were "much more substantive than mere temporary storage in California for purposes of further shipment elsewhere in the stream of interstate commerce."

Following these two decisions, the Franchise Tax Board issued Legal Ruling 95-3, expressly withdrawing Legal Ruling 348 and stating that the Franchise Tax Board would follow the holding in *McDonnell Douglas, supra*. Legal Ruling 95-3 includes a number of scenarios. Situation 4 appears to be the most similar to the facts presented here. In this example, the purchaser transports the machinery to State A and then places the machinery with a common carrier in State A and arranges shipment to its own place of business in State B. The Ruling provides:

The purchaser did not have possession of the machinery in California or in State A for purposes other than in the process of shipment. Thus, the purchaser's receipt at its place of business in State B will control the application of Section 25135(a). If the seller is taxable in State B, the sale is a State B sale. If not, the sale is thrown back to California. The seller's taxability in State A is irrelevant.

Legal Ruling 95-3 also provides that while there is a presumption that goods taken into possession by the purchaser in California are presumed to be delivered or shipped to California for purposes of sales factor assignment, that presumption can be overcome by evidence proving that the property was not used in the state and was transported to another state. The taxpayer has met this burden. Borrowing from the language in *Mazda Motors*,

supra, the activities of the 3PL are no more substantive than mere temporary storage in California. The **** are stored in California for a limited period of time and are shipped in the same form received to the ultimate destination known at the time of shipment. As such, the goods are not used in this state through activities such as warehousing, repackaging, etc. Moreover, since the ultimate destination is designated by the taxpayer at the time of the initial order and is separately billed to the division in the ultimate state of destination, the temporary storage in this state is merely for purposes of further shipment elsewhere in the stream of interstate commerce. Accordingly, the sales should be apportioned to the state of destination.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Kathryn Frank
Tax Counsel