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12.23.2020

Chief Counsel Ruling 2020 - 02

RE: Chief Counsel Ruling Request for *****; *****
 *****; *****; and *****

Dear *****,

This letter is in response to your Chief Counsel Ruling ("CCR") request dated ***** **, *****. In the request, you ask for the Franchise Tax Board's ("FTB") guidance as to the assignment of sales of tangible personal property for California franchise and income tax purposes.

FACTS

***** ("*****"), headquartered in ***** , is in the business of selling tangible personal property (interchangeable with "products"). As relevant to this ruling, ***** affiliates include ***** , ***** , ***** , ***** , and ***** (collectively, the "*****"), all of which are also in the business of selling tangible personal property. ***** and its affiliates file a combined report in California pursuant to Revenue and Taxation Code section 25105, subdivision (a).

The ***** sells its products to various purchasers, including ***** , ***** ("*****") outside of California and ***** , ***** ("*****") in California. ***** , headquartered in ***** , is in the business of wholesaling and distributing tangible personal property throughout the nation from various distribution centers in several states, including California. ***** or its wholly-owned affiliates (collectively, the "*****") operate the centers. One such affiliate is ***** , which operates from distribution centers in ***** , ***** , and *****.

The ***** will transport nearly all the products it sells to the ***** via common carrier to the new ***** consolidation warehouse in

*****.¹ Upon shipment of its products to *****, the *****, the *****, relinquishes title and risk of loss of the products to *****. Also, the *****, will not know the destination of ***** resales of their products, nor will the *****, be involved in adding accessories or modifying the products at ***** consolidation warehouse. Upon ***** receiving the *****, *****, products at its warehouse, ***** will conduct the following activities, among others: provide additional packaging, add additional labeling to provide proof of state taxation, and/or store the goods while ***** awaits orders from its customers. As relevant herein, ***** will resell a portion of the products purchased from the *****, *****, to *****, and unrelated third parties in California.

ISSUE

For taxable years beginning on January 1, 2020, and onward, whether sales of tangible personal property from the *****, *****, to *****, at the *****, consolidation warehouse in ***** are assigned to California for the *****, *****, pursuant to Revenue and Taxation Code section 25135.

HOLDING

For taxable years beginning on January 1, 2020, and onward, sales of tangible personal property from the *****, *****, to *****, which are delivered at the *****, consolidation warehouse in ***** to be prepared for resale to *****, *****, in California among other customers, are not assigned to California for the *****, *****, *****.

DISCUSSION

Corporations doing business in California are subject to a corporation franchise or income tax based on net income.² Income is apportioned using a single sales factor formula.³ The sales factor is a fraction, the numerator of which is the total sales in California during the taxable year, and the denominator of which is the total sales everywhere during the taxable year.⁴

¹ For clarification, the *****, *****, intends to transport almost 100 percent of the products sold to the *****, *****, to the *****, consolidation warehouse in ***** under the new distribution model. However, the *****, *****, has supplied products directly to *****, *****, in California in the past, and will continue to sell some products directly to *****, *****, in California. As such, the *****, *****, is requesting a ruling only in connection to the products it ships to the *****, consolidation warehouse in *****.

² Revenue and Taxation Code section 23151.

³ Revenue and Taxation Code section 25128.7.

⁴ Revenue and Taxation Code section 25134.

Sales of tangible personal property are assigned to California if 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."⁵

The following legal authorities help clarify the meaning of "delivered or shipped to a purchaser...within this state" for sales factor assignment purposes. In *McDonnell Douglas Corporation v. Franchise Tax Board* (1994) 26 Cal.App.4th 1789 ("*McDonnell Douglas*"), the Court of Appeal affirmed the trial court's decision to apply the "destination rule" rather than the "place of delivery" rule, which articulated that delivery to a purchaser in California was not considered a sale within the state if the products were ultimately destined for use in another state.⁶ The Court determined that delivery did not occur within California if a purchaser merely picked up the products in California for shipment to an out-of-state destination. In *Appeal of Mazda Motors of America, Inc.*, 94-SBE-009, November 29, 1994 ("*Mazda Motors*"), decided after *McDonnell Douglas*, the Board of Equalization ("Board") held that storing and adding accessories to vehicles initially shipped to California and then subsequently shipped to another state, caused shipment to terminate and delivery to occur within this state.⁷ In doing so, the Board distinguished the sales in *Mazda Motors* from the sales in *McDonnell Douglas* where the out-of-state purchaser merely picked up the products in this state and immediately transported the goods outside of the state. The Board indicated that the activities in *Mazda Motors*, which included, among other activities, adding accessories and storing the products in this state via an agent, were more substantive than temporary storage in the state for purposes of further shipment outside of the state.

In response to the *McDonnell Douglas* and *Mazda Motor* cases, the FTB issued Legal Ruling 95-3, which provides in relevant part that if a purchaser takes possession in a state for a purpose other than transportation to another state, the purchaser is considered "within the state" for purposes of Revenue and Taxation Code section 25135.⁸ Also, for a sale to be a California sale under Revenue and Taxation Code section 25135, subdivision (a), both the fact of delivery or shipment within this state and receipt by a purchaser within this state are required.⁹ Additionally, the ruling explains that one way property may be delivered or shipped to a purchaser within this state is through the purchaser receiving property at its own place of business within the state.¹⁰

⁵ Revenue and Taxation Code section 25135(a)(1).

⁶ In *McDonnell Douglas*, the taxpayer manufactured commercial and military aircraft and aircraft parts in California and transferred physical possession of the aircrafts to the purchaser's employees in this state. The purchaser's employees then arranged for transportation of the aircraft outside of California.

⁷ In *Mazda Motors*, some of the products entered the United States through two ports in California and were placed in storage facilities maintained by the taxpayer at the ports in California.

⁸ FTB Legal Ruling No. 95-3 (July 20, 1995), pp. 6-7.

⁹ FTB Legal Ruling No. 95-3 (July 20, 1995), p. 3.

¹⁰ FTB Legal Ruling No. 95-3 (July 20, 1995), p. 3.

Situation 3 in Legal Ruling 95-3 provides the closest analogy to the facts presented in this ruling:

The purchaser takes title and physically receives the machinery in California, and uses its own truck to transport the machinery to another state. [Then] the purchaser transports the machinery to its own place of business in State A, and a few days later transports the machinery to another of its places of business in State B using its own transportation vehicle.¹¹

For sales factor assignment purposes, the outcome for Situation 3 is:

Because the purchaser took possession of the machinery at its place of business in State A, the machinery is considered shipped to a purchaser in State A. The shipment and sale is considered terminated in that state, and the subsequent transportation of the machinery to State B has no effect on the application of the sales factor.¹²

In this case, the ***** will cease to be involved in the sales process once they ship their products to *****. The ***** will not know the destination of their products resold by ***** , nor will the ***** be involved in any modification of the products conducted at ***** consolidation warehouse. Once ***** receives the products from the ***** , ***** will utilize the consolidated warehouse beyond that of temporary storage for purposes of immediate transport outside of ***** by: providing additional packaging, adding additional labeling to provide proof of state taxation, and/or storing the goods while ***** awaits orders from its customers. Thereafter, ***** will ship or deliver the products to its customers. Thus, ***** activities at its consolidated warehouse are similar to Situation 3 in Legal Ruling 95-3 and *Mazda Motors*. As a result, these sales terminate in ***** and do not constitute mere temporary storage for purposes of shipment outside of the state. Any subsequent transportation by ***** of the products purchased from the ***** to its affiliates and unrelated third parties in California does not alter the state to which the sales should be assigned. For the ***** , the sales are not assigned to California for sales factor assignment purposes. For the ***** , the resales of those same products to ***** and unrelated third parties in California, will be assigned to California as appropriate.

CONCLUSION

Sales of tangible personal property by the ***** to ***** , which are delivered to ***** consolidation warehouse in ***** terminate in ***** , and thereby, are not includable in the California sales factor numerator of the *****

¹¹ FTB Legal Ruling No. 95-3, p. 6.

¹² FTB Legal Ruling No. 95-3, p. 6.

****. This ruling does not apply to any direct sales by the **** ***** ***** to
***** ***** in California.

Please be advised that the tax consequences expressed in this CCR are applicable only to the named taxpayers 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 FTB'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,

Laura Taing
Tax Counsel