

California Enacts Click-Through and Controlled Group Use Tax Nexus Provisions; Temporary Sales and Use Tax Rate Increase Expires

July 7, 2011

Overview

California Governor Jerry Brown recently signed the 2011-2012 budget bill (S.B. 87)¹ and related trailer bills, addressing California's estimated \$26.6 billion deficit through a combination of expenditure cuts and revenue increases (including revised revenue projections based on an estimated increase in tax receipts). While certain contemplated tax increases had been part of the governor's budget proposal since January, the significant tax impact in the final budget relates to use tax nexus as applied to out-of-state retailers. These nexus provisions are contained in trailer bill A.B. X1 28.²

The following three tax proposals were *not* included in the final 2011-2012 budget: (1) a proposal to extend tax increases originally enacted as part of the 2008-2009 budget, which would have impacted personal income tax, the vehicle license fee, and the state-level sales and use tax rate; (2) a proposal to mandate single sales factor apportionment with market-based sourcing for sales of services and intangibles; and (3) a proposal to repeal or greatly reduce the availability of new, and utilization of existing, Enterprise Zone hiring credits. Since none of those proposals were contained in the 2011-2012 budget, the California statewide sales and use tax rate automatically decreased by 1% effective July 1, 2011, single sales factor apportionment remains elective, and the Enterprise Zone hiring credits remain intact.³

The remainder of this Tax Alert summarizes the use tax nexus provisions enacted under A.B. X1 28 and the expiration of the sales and use tax rate increase.

Expanded Use Tax Nexus

Prior to the enactment of A.B. X1 28, a "retailer engaged in business in this state" included retailers performing specified activities in California, such as maintaining an office or having a sales representative. Signed by the Governor on June 28, 2011, A.B. X1 28 amends Revenue and Taxation Code ("R&TC") § 6203 to provide that a "retailer engaged in business in this state" is one with substantial nexus with California "for purposes of the Commerce Clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."⁴ A.B. X1 28 also specifically identifies two types of retailers that fall within the definition of a "retailer engaged in business in this state," namely, those retailers that have "click-through" nexus and those that have "controlled group" nexus, as defined below.

Click-Through Nexus

Under A.B. X1 28, a "retailer engaged in business" in California includes any retailer that enters into an agreement with a person in California, for a commission or other consideration, to directly or indirectly refer potential purchasers of tangible personal property to the retailer by an Internet-based link or an Internet website, or otherwise, provided that the following requirements are met:

¹ S.B. 87, ch 33, Statutes of 2011 (June 30, 2011).

² A.B. X1 28 (1st Ex. Sess.), ch 7, Statutes of 2011 (signed by Governor Brown on June 28, 2011).

³ The personal income tax rate increase and the increased vehicle license fee have also expired.

⁴ A.B. X1 28, § 1, amending R&TC § 6203(c).

- The total cumulative sales price from all of the retailer’s sales, within the preceding 12 months, of tangible personal property to California purchasers that are referred pursuant to the specified agreements is in excess of \$10,000; and
- The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to California purchasers in excess of \$500,000.⁵

The specified “agreements” required for “click-through” nexus do not include purchases of advertisements from a person in California unless commissions or other consideration based upon sales of tangible personal property are paid to the person in California for the advertisements.⁶ “Agreements” also do not include engaging a person in California to place an advertisement on a website operated by the person, or operated by another person in the state, unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in California through flyers, newsletters, telephone calls, electronic mail, blogs, micro blogs, social network sites, or other means of direct and indirect solicitation specifically targeted at potential customers in California.⁷

For purposes of the click-through nexus provision, a “retailer” also includes any “entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code.”⁸

Controlled Group Nexus

Under A.B.X1 28, a “retailer engaged in business” in California also includes:

Any retailer that is a member of a commonly controlled group . . . and is a member of a combined reporting group . . . that includes another member of the retailer’s commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in [California] in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer.⁹

Sales and Use Tax Rate Reduction

As part of the 2008-09 budget agreement, the General Fund portion of the sales and use tax rate was temporarily increased by 1% on April 1, 2009, with a scheduled sunset date of June 30, 2011. Because this rate increase was not extended as part of the 2011-2012 budget, the California statewide sales and use tax rate decreased from 8.25% to 7.25% effective July 1, 2011.

The 1% decrease generally applies to all taxable transactions in California. In local jurisdictions where voters have approved additional sales taxes, the total rate applied to purchases is the statewide rate (7.25%) plus any applicable sales taxes for special taxing districts for a total rate ranging between 7.25% and 9.75%.

Considerations

Remote sellers may want to review their use tax collection practices in light of California’s expanded nexus provisions and similar law changes by other states. Failure to collect use tax from the customer at the time of sale may result in the seller being held liable for the tax, interest, and penalties, with potentially limited opportunity to seek recourse from the buyer with regard to the unpaid tax.

⁵ A.B. X1 28, § 1, adding R&TC § 6203(c)(5)(A).

⁶ A.B. X1 28, § 1, adding R&TC § 6203(c)(5)(B).

⁷ A.B. X1 28, § 1, adding R&TC § 6203(c)(5)(C).

⁸ A.B. X1 28, § 1, adding R&TC § 6203(c)(5)(D).

⁹ A.B. X1 28, § 1, amending R&TC § 6203(c)(4).

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