

State of California  
**BOARD OF EQUALIZATION**  
**SALES AND USE TAX REGULATIONS**

**Regulation 1706. DROP SHIPMENTS.**

*References:* Sections 6007, 6091, and 6203, Revenue and Taxation Code.

**(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 a 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 an owner or former owner thereof, or factor or agent of that owner or former owner, who makes a drop shipment of tangible personal property.

**(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) 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 (c)(3) of this regulation, for reporting periods commencing on or after January 1, 2001, a 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 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 (c)(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, respectively.

**Regulation 1706. (Continued)**

**(d) 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 developed and applied a mark-up of 8½ percent. During the current audit, the Board develops a mark-up of 11 percent. The Board 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 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 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. 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 will apply a mark-up of 10 percent (because it is lower than the 11 percent mark-up developed during the audit).

**(e) 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 California consumer is presumed to be a drop shipper liable for the applicable tax as the retailer. A person may overcome this presumption by accepting a timely resale certificate from that person's customer that includes 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.

(2) A person otherwise qualifying as a drop shipper under this regulation can overcome the presumption that the delivery is to a consumer by accepting a timely and valid resale certificate in good faith from the person in California to whom the property is delivered.

*History: Adopted September 13, 2000, effective December 28, 2000.*

*Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.*