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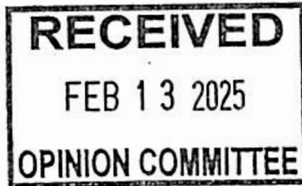

SENATOR PAUL BETTENCOURT
DISTRICT 7

Office of the Attorney General
Attention Opinion Committee
P.O. Box 12548
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opinion.committee@oag.texas.gov

Re: Request for Attorney General Opinion

Dear General Paxton:

Pursuant to Section 402.042 of the Texas Government Code I write to request your opinion on the following question:

> In claiming a credit against Texas use tax under Texas Tax Code§ 151.303(c) for sales tax paid to another state on the same taxable item, may a taxpayer satisfy Texas Comptroller Rule 3.338(b)'s requirement that such sales tax be legally imposed by and legally due to that state with a letter ruling from that state's taxing authority concluding that sales tax is legally due?

Background Information

Multiple Texas purchasers have contracted to purchase tangible personal property from different resellers operating sales offices exclusively in Louisiana. Such resellers have no places of business in Texas.

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The concerned Texas purchasers have paid Louisiana sales tax on their purchases from these resellers. These purchases were executed in Louisiana by contractual arrangements transferring title to the goods in Louisiana, and then fulfilled via drop-shipments by unrelated third party shippers to the purchasers' Texas locations. Each reseller received a letter ruling from the Louisiana Department of Revenue addressing the specific facts and concluding that Louisiana sales tax would be legally imposed and due on those transactions. In reliance on those Louisiana rulings and believing the tax to be legally due, the Texas purchasers paid the applicable Louisiana sales tax to the resellers on their purchases. They then credited the sales tax paid against Texas use tax that would otherwise have been due on the items purchased, believing the Louisiana rulings satisfied Rule 3.338(b)'s requirements that the out-of-state sales tax was legally imposed and legally due. As a result, the purchasers paid Texas use tax on the purchases only to the extent the use tax due exceeded the Louisiana sales tax paid.

The resellers and purchasers at issue have subsequently been audited for Texas sales and use tax. In the audits, these affected taxpayers have presented the Louisiana letter rulings as evidence that the sales tax paid to Louisiana was legally imposed and legally due such that the claimed credits against Texas use tax were proper. The Texas Comptroller, however, has declined to accept those rulings as proof that the Louisiana sales tax was legally imposed or due. Not accepting another state's taxability determination would seem to leave Texas taxpayers without a practical way of establishing prior to paying tax in that state that they have met Rule 3.338(b)'s "legally imposed" and "legally due" requirements, and thereby avoiding a second layer of tax (Texas use tax) on the same transactions.

As the legal authority below makes clear, the question presented implicates principles of interstate comity and thus affects the State as a whole. It also affects the ability of Texas-based businesses to conduct interstate transactions without significant risk of multiple taxation.

Legal Authority

For taxable items purchased outside of Texas, use tax is imposed on the storage, use, or other consumption of a taxable item in Texas, at the same rate as the sales tax. Tex. Tax Code § 151.101(a) & (b). "The use tax complements the state sales tax and is designed to tax transactions not reached by the sales tax." *Combs v. Chapa! Zenray, Inc.*, 357 S.W.3d 751, 756 (Tex. App.-Austin 2011, pet. denied) *(citing Bullock v. Foley Bros. Dry Goods Corp.*, 802 S.W.2d 835, 838 (Tex. App.-Austin 1990, writ denied)).

Consistent with the complementary nature of the sales and use taxes, "[t]he storage, use, or other consumption of a taxable item the sale of which is subject to the sales tax is exempted from the use tax." Tex. Tax Code § 151.303(a). Likewise, a "taxpayer is entitled to a credit against the use tax ... in an amount equal to the amount of any similar tax paid by the taxpayer in another state on the sale, purchase, or use of the taxable item." *Id.* § 151.303(c).

Comptroller Rule 3.338(b), promulgated to effectuate Texas Tax Code § 151.303(c). states that "Texas will allow as a credit against Texas use tax due any combined amounts of legally imposed sales or use taxes paid on the same item to another state or any subdivision of another state," while the credit "will not be allowed for sales tax paid to another state that was not legally due and paid to another state." 34 Tex. Admin. Code§ 3.338(b)(1). (6).

As discussed below, Texas law and policy appear to dictate that, in determining whether sales or use tax paid to another state was legally imposed by and legally due to that state, the Comptroller give weight and deference to the analysis and conclusions of that state's taxing agency on the question-just as the Comptroller would expect another state to defer to a Comptroller determination that a taxpayer owed Texas tax. It would seem, therefore, that a taxpayer should be able to satisfy Rule 3.338(b)'s legally imposed and due requirements with a written taxability determination from the state to which the taxpayer paid sales tax.

Rule 3.338(a)(1) clarifies that the use tax credit was enacted to "avoid double taxation of multistate taxpayers." The credit thereby plays an important role in defending Texas's use tax against constitutional attack. The United States Supreme Court has observed that statutes that provide credit against use tax for sales tax paid in other states on the same transaction provide a mechanism for satisfying the requirement that a tax be fairly apportioned and avoid undue risk of multiple taxation in order to pass muster under the Commerce Clause of the U.S. Constitution. *See Goldberg v. Sweet,* 488 U.S. 252, 257-58 (1989) (citing *Complete Auto Transit, Inc. v. Brady* (430 U.S. 247, 287-88 (1977))). Rule 3.338(b)'s requirement that the other state's tax be legally imposed should therefore be applied with the primary statutory objective of avoiding multiple taxation. Disregarding the taxability determinations of another state's taxing agency in evaluating whether that state's tax was legally imposed creates a high risk that a transaction will be taxed multiple times, which would appear to be contrary to the purpose of Tax Code § 151.303(c), the U.S. Constitution, and applicable case law.

The codified state policy of extending comity to the taxability determinations of Texas's sister states, moreover, strongly suggests the Comptroller should accept those determinations. Specifically, Texas Tax Code § 151.615 requires Texas courts to "recognize and enforce a liability for a sales or use tax lawfully imposed by another state if the other state extends a like comity to this state." Louisiana extends a like comity, codified in Section 47:3 of the Louisiana Revised Statutes. If Texas courts are obliged to recognize and enforce such a tax liability determination, there is no apparent reason the Comptroller should not be similarly obliged. Indeed, the Comptroller's disregarding of another state taxing agency's determination would seem to undermine the codified principles of interstate comity just as much as if a Texas court were to do the same.

Accepting the conclusions of the taxing state's taxing agency is also consistent with Texas case law approving of granting deference to an agency's construction of laws it is charged with enforcing, particularly when the law involves complex subject matter within the agency's area of expertise. *See, e.g., First Am. Title Ins. Co. v. Combs,* 258 S.W.3d 627, 632 (Tex. 2008), cert. denied, 556 U.S. 1221 (2009). The Louisiana Department of

Revenue, and not the Texas Comptroller, is charged with enforcing the Louisiana sales tax. And the Louisiana sales tax is within the Louisiana Department of Revenue's area of expertise, not the Texas Comptroller's.

The Comptroller's published policy further indicates it should be the Comptroller's practice to accept Louisiana's taxability determinations in situations like this. Specifically, in Comptroller Decision No. 36,403 (Oct. 28, 1997), the administrative law judge's decision (which the Comptroller approved and adopted) stated an "understanding that Texas gives due deference to Louisiana's taxability interpretation" in determining "whether the Louisiana sales tax paid by Petitioner was legally imposed," as Rule 3.338(b) requires.

Finally, the above law and policy for deference seems particularly appropriate given that it is the Comptroller's own Rule, rather than the statute, that imposes the requirements that any sales or use taxes paid to another state be "legally imposed" and "legally due" for those taxes to be the basis of a Texas use tax credit. *See id.* While this is a reasonable regulatory requirement for the Comptroller to impose, it would seem to be a step too far for the Comptroller to interpret its own requirement in a way that leaves no practical path for taxpayers to satisfy it.

Conclusion

Based on the relevant legal authority, it appears that a taxpayer seeking a Texas use-tax credit for sales tax paid to another state should be able to prove that the other state's sales tax was legally imposed and legally due-satisfying Rule 3.338(b)'s requirements-with a taxability determination by that state's taxing agency concluding as much.

Thank you for your consideration of this issue. Please do not hesitate to contact me if you require any additional information prior to providing your opinion.

Sincerely,

Senator Paul Bettencourt
Senate District 7

SENATOR PAUL BETTENCOURT
DISTRICT 7

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Re: Request for Attorney General Opinion on Texas Tax Code§ 151.051(a)

Dear General Paxton:

Pursuant to Section 402.042 of the Texas Government Code I write to request your opinion on the following question concerning Texas's taxation of certain drop-shipment transactions:

> An out-of-state retailer with no place of business in Texas purchases goods from a supplier for resale by the retailer to the retailer's customer in Texas. The supplier delivers ("drop-ships") the goods from its location (which may be inside or outside of Texas) to the retailer's Texas customer. Is the sale from the retailer to its customer subject to sales tax under Subchapter C of Texas Tax Code. Chapter 151, or use tax under Subchapter D of Texas Tax Code. Chapter 151?

Background Information

Subchapter C of Texas Tax Code, Chapter 151 imposes Texas sales tax on "each sale of a taxable item in this state" (Texas Tax Code § 151.051(a)) while Subchapter D imposes Texas use tax "on the storage. use, or other consumption in this state of a taxable item purchased from a retailer for storage, use, or other consumption in this state" (Texas Tax Code § 151.101).

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The relevant authorities (discussed below) seem to consistently suggest that use tax, and not sales tax, would apply to the above transaction, regardless of whether the goods are delivered from a location inside, or outside Texas, because in this drop-ship scenario, the place where the sales transaction is completed, rather than the place where the goods are located to fulfill the drop-shipment, determines whether sales tax or use tax applies. That is, the words "in this state" in Section 151.05l(a) appear to properly refer to "each sale" rather than "a taxable item," such that if the sales transaction occurs outside of Texas, the Texas use tax would apply whether or not the sold goods are shipped from Texas.

It can be critical whether the sales tax, or the use tax, applies to these common drop-shipment transactions because Texas Tax Code § 151.303(c) provides a credit against Texas use tax for sales tax paid in another state on the same purchase, but this credit cannot be used to offset Texas sales tax, meaning that if both Texas and another state impose sales tax on the same transaction, the transaction can be taxed twice.

Although the below authorities appear to support treating a drop-shipment involving an out-of-state seller as an out-of-state sale subject to use tax, Texas courts have not squarely answered this precise question, leaving Texas taxpayers who buy goods from out-of-state sellers, who then fulfill those purchases via third-party drop-shipments, with uncertainty over their tax obligations and at risk of multiple taxation. My understanding is that most states respect the contractual form of drop-shipments (sale from supplier to seller, followed by resale from seller to purchaser) for sales and use tax purposes, so any uncertainty about whether Texas does the same could place Texas-based businesses that participate in these everyday transactions at a competitive disadvantage. Your opinion and analysis of how a Texas court would likely address this common scenario will therefore be of tremendous value to Texas businesses.

Legal Authorities

I. Statutory text, nature of the sales tax, and relevant case law

The sales tax is by its nature a *transaction* tax, imposed not directly upon taxable items themselves, but rather on the transaction by which the taxable items are transferred- "*each sale* of a taxable item in this state." Tex. Tax Code§ 151.05l(a) (emphasis added); *see, e.g., Calvert v. Canteen Co.*, 371 S.W.2d 556, 558 (Tex. 1963) (stating that the sales tax "is upon *the transaction*") (emphasis added); *Davis v. State*, 904 S.W.2d 946,952 (Tex. App.-Austin 1995, no writ) ("[T]he sales tax is characterized as a *transaction tax* imposed on each *sale* of a taxable item) (emphasis added).

Because it is the transaction, and not the property, that is subject to the sales tax, it must logically follow that the location of the transaction, and not the location of the item sold, is the key factor for determining whether Texas sales tax (as opposed to Texas use tax) is due. The relevant case law appears to support this conclusion. For example:

> The sales tax is a transaction tax ... that is imposed on the sale of tangible personal property in this state A use tax, on the other hand, is assessed when a party stores, uses or consumes a taxable item within the state.... The *use tax* is designed to complement the sales tax and applies to situations in which the taxing authority is unable to assess a sale tax because the *purchase took place outside its taxing jurisdiction* and the *property purchased is stored or used within its jurisdiction.*

Verizon Bus. NetworkServ's. Inc. v. Combs, No. 07-11-0025-CV, 2013 WL 1343530, at *5-6 (Tex. App.-Amarillo Apr. 3, 2013, pet. dism'd) (citations and footnotes omitted).

The Supreme Court stated it more succinctly. "The Sales Tax, by definition, can only reach those *transactions* which occur in this State." *Bullock v. Lone Star Gas* Co., 567 S.W.2d 493,497 (Tex. 1978) (emphasis added). These statements are consistent with the statutory imposition of sales tax on a "transfer of title *or* possession of tangible personal property" (Texas Tax Code§ 151.005(1)). Because this statute makes clear that a transfer of title can subject a transaction to sales tax independent of the physical transfer of the sold property, the location of the property cannot be dispositive in determining where a sale subject to sales tax occurs.

The statutes governing sales tax permits are consistent with requiring a drop-shipping retailer with no Texas place of business to collect use tax rather than sales tax (regardless of from where the goods are shipped), because a retailer without a Texas place of business cannot obtain a Texas sales tax permit. Under Texas Tax Code§ 151.201, a sales tax permit is issued only for a place of business in Texas, and under Texas Tax Code § 151.202, only a seller with a Texas place of business may apply for a sales tax permit. In the scenario here, the retail seller has no place of business in Texas.

II. Texas Comptroller Rules

In addition to the statute and case law interpreting it, a number of Texas Comptroller rules-specifically those dealing with drop-shipment transactions-would necessarily be written differently if the location of the items sold, not the location of the sale, determined whether the sales tax or the use tax applied.

A. Rule 3.285(d)(3)

When an out-of-state retailer fulfills a sales order to its Texas customer by paying a Texas retailer to drop-ship the goods to that Texas customer, Rule 3.285(d)(3) allows the Texas retailer to accept a resale certificate from the out-of-state retailer "even if the Texas retailer ships or delivers the taxable item directly to a recipient located inside Texas." *See* 34 Tex. Admin. Code§ 3.285(d)(3). The Rule also provides that the out-of-state reseller need not have a Texas sales-tax permit but may instead list the registration number issued by a different state on that resale certificate. *See id.* If the out-of-state retailer's sale to its Texas customer were subject to Texas sales tax solely on the basis of the drop-shipment of

the goods to the Texas customer, the out-of-state retailer would necessarily have needed to collect Texas sales tax, for which it would have needed a Texas sales tax permit. That it is instead allowed to issue a resale certificate to the Texas retailer, using its home-state registration number, further suggests that it is the *location of the sale*, not the goods sold, that determines whether Texas sales tax (and not use tax) is due.

B. Rule 3.285(d)(S) and Rule 3.286

Rule 3.285(d)(5) further confirms this conclusion by providing that "an out-of-state or foreign purchaser who acquires goods or services from a Texas seller for resale in Texas should refer to Rule 3.286 for information on their responsibilities." 34 Tex. Admin. Code § 3.285(d)(5). Rule 3.286 provides guidelines on when a seller is required to collect sales or use tax, and makes clear that out-of-state sellers whose only connection to Texas is remotely selling over $500,000 of goods into the state are required to collect Texas *use* tax. Rule 3.286(b)(2)(E). If the presence of goods in Texas in a drop-shipment transaction were itself dispositive in subjecting the transaction to Texas sales tax, Rule 3.285(d)(5)'s reference to Rule 3.286 would be pointless. It would instead simply require the out-of-state retailer to collect Texas sales tax in all drop-shipment transactions in which the goods sold were supplied by a Texas drop-shipper.

III Texas Comptroller Letter Rulings and Policy Statements

Comptroller letter rulings are, of course, binding only on the taxpayer recipient. But because they offer relevant insight into how the Comptroller has applied the sales and use tax statutes to drop-shipment transactions, I mention two, along with a related policy statement.

First, in Letter Ruling No. 781L0102B06 (Jan. 26, 1978), the Comptroller advised that Texas state use tax applied where a retailer took an order at its place of business outside Texas for delivery by an unrelated third-party vendor to a customer in Texas, with delivery occurring from the third-party vendor's place of business in Texas. Because the retailer took the order from its customer outside Texas, the transaction was subject to state use tax, not sales tax, even though the goods sold were always in Texas. This interpretation is consistent with a reading of Tax Code Section 151.05l(a) that "in this state" refers to the location of the sale, not the taxable items.

Second. Letter Ruling No. 200002088L (Feb. 29, 2000) addressed a drop-shipment transaction in which Texas Company A sold to out-of-state Company B, then delivered the goods directly to Company B's Texas customer, Company C. The Comptroller advised that Company C owed Texas use tax (not sales tax) and that if Company B was not "engaged in business" in Texas, it would not be required to collect or remit this use tax but that Company C would be required to pay the use tax directly.

Finally, in the December 2011 edition of the Comptroller's Tax Policy News, the Comptroller stated-consistent with the earlier letter rulings and authorities above-that when a purchaser buys a taxable item from an out-of-state seller for use in Texas, the seller

collects Texas use tax even if engaged in business in Texas. *See* Texas Policy Letter Ruling No. 201112316L (Dec. 1, 2011). The Comptroller reaffirmed that guidance when his office updated that tax policy guidance after the U.S. Supreme Court decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2018 (2018) to confirm that remote sellers were now engaged in business in Texas but were nonetheless required to collect use tax on sales occurring outside the state of goods that were delivered in Texas. Specifically, the Comptroller added the bracketed note below but otherwise kept the 2011 guidance:

> TEXAS BUYER, OUT-OF-STATE SELLER
>
> When a purchaser buys a taxable item from an out-of-state seller for use in Texas, and the seller is engaged in business in Texas, the seller must collect Texas use tax. If the seller is engaged in business at the point of delivery, the seller must also collect any local use tax due. [NOTE: If a seller is considered a remote seller (as defined by Rule 3.286 effective 01/01/2019), the seller is considered engaged in business at point of delivery.]

Tex. Comptroller Note No. 201112316N (Nov. 4, 2021) (partially superseding Texas Policy Letter Ruling No. 201112316L (Dec. 1, 2011)).

Conclusion

The relevant legal authorities appear consistent that because the sales tax is a transaction tax, the location of the sale, not the items sold, determines whether Texas sales tax (as opposed to Texas use tax) applies-with the result that the drop-shipment transactions described in this request are subject to use tax under Subchapter D. and not sales tax under Subchapter C. However, because Texas courts have not squarely and directly confirmed that, in Texas Tax Code§ 151.051(a), the words "in this state" properly refer to "each sale" rather than "a taxable item," your opinion and analysis on how a court is likely to decide this question would be of great value.

Sincerely,

Senator Paul Bettencourt
Senate District 7