

## TIR 07-10: Drop Shipment

### Sales and Use Tax

#### I. INTRODUCTION

On February 23, 2007, the United States Court of Appeals for the Third Circuit affirmed the decisions of the Delaware Bankruptcy and District Courts disallowing the Department's sales tax claim against Valley Media, Inc. ("*Valley Media*"). *Mass. Dep't of Revenue v. Valley Media, Inc. (In re Valley Media, Inc.)*, 2004 Bankr. Lexis 2061 (Bankr. D. Del. 2004), *aff'd* 338 B.R. 605 (D. Del., 2006), *aff'd* 2007 U.S. App. Lexis 4189 (3d Cir. 2007). The *Valley Media* decisions rendered by federal courts in Delaware were contrary to the Department's longstanding interpretation of G.L. c. 64H, § 1, however the Department will not contest the underlying issue of passage of title to a common carrier outside of Massachusetts in other open cases relating to transactions prior to the 2004 statutory amendment to G.L. c. 64H, § 1.

#### II. DISCUSSION

##### A. *Brief Statement of Fact*

The issue in these cases is whether sales of music and video material by *Valley Media* occurred in California or Massachusetts for the purpose of the Massachusetts sales tax statute. *Valley Media*, a corporation based in Woodland, California, contracted with Internet vendors to fill orders taken by the Internet vendors, including orders by customers located in Massachusetts. Under the contracts, the Internet vendors placed orders with *Valley Media*, and *Valley Media* shipped the material directly to the customer from California (a "drop shipment"). It was agreed that the Internet vendors did not have sales tax nexus in Massachusetts. *Valley Media* had nexus with Massachusetts by virtue of its ownership and operation of a warehouse in Massachusetts.

The Department argued that the drop shipment statute imposed liability for the sales tax on *Valley Media*, because "delivery" of the product, within the meaning of the drop shipment statute, occurred when the customers in Massachusetts received the goods. However, the Court of Appeals agreed with the Bankruptcy Court and the District Court, holding that the term "delivery" has a well-accepted meaning in sales transactions, in particular the Uniform Commercial Code ("UCC"), Article II, Sales of Goods, and refers to the place of shipment – in this case, California.

##### B. *Massachusetts Drop Shipment Provisions as Amended in 2004*

The definition of "sale at retail" or "retail sale" of G.L. c. 64H, § 1, as amended by St. 2004, c. 9, § 48, an emergency act, effective August 9, 2004 (*see generally TIR 04-26: Sales/Use Tax Changes Contained in Chapter 262 of the Acts of 2004*), provides the following: "When tangible personal property is physically delivered by an owner, a former owner thereof, a factor, or an agent or representative of the owner, former owner or factor, to the ultimate purchaser residing in or doing business in the commonwealth, or to any person for redelivery to the purchaser, pursuant to a retail sale made by a vendor not engaged in business in the commonwealth, the person making or effectuating the delivery shall be considered the vendor of that property, the transaction shall be a retail sale in the commonwealth by the person and that person, if engaged in business in the commonwealth, shall include the retail selling price in its gross receipts, regardless of any contrary statutory or contractual terms concerning the passage of title or risk of loss which may be expressly or impliedly applicable to any contract or other agreement or arrangement for the sale, transportation, shipment or delivery of that property."<sup>[1]</sup>

##### C. *Conclusion*

Generally, a company shipping goods to a Massachusetts customer may not avoid the application of the “drop shipment” statute through contractual provisions governing passage of title. Massachusetts law requires a wholesaler with nexus in Massachusetts to collect the sales tax when it ships goods into the Commonwealth in connection with a sale made by an unregistered retailer that does not have nexus in Massachusetts. The *Valley Media* decisions were based on the Massachusetts “drop shipment” provisions in place prior to the 2004 statutory amendment, and do not consider the amended statute, which clarified the statutory intent of the drop shipment provisions. The amended drop shipment statute applies to transactions on and after August 9, 2004.<sup>[2]</sup>

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<sup>[1]</sup> Prior to amendment, this sentence read: “The delivery in the commonwealth of tangible personal property by an owner or former owner thereof, or by a factor, or agent of such owner, former owner or factor, if the delivery is to a consumer or to a person for redelivery by a retailer not engaged in business in the commonwealth, is a retail sale in the commonwealth by the person making the delivery.” The *Valley Media* decisions interpreted the statute in this form, without the clarifying language added in 2004.

<sup>[2]</sup> Most transactions under the prior law are currently outside of the statute of limitations in G.L. c. 62C, § 37.