

M e m o r a n d u m**325.0009**

To: Subject Matter File on Interstate Commerce

Date: September 15, 1983

From: Donald J. Hennessy

Subject: S--- O--- of California

SP -- XX-XXXXXXX-010

In a meeting on September 13, 1983, Gary Jugum decided that the flights from one point to in a state to another point in that same state would result in tax on the purchase of the aircraft as long as at least one of its flights were in California. If the only interstate flight had been in a state other than California we would not apply the tax. There seemed to be unanimous agreement at the meeting that, while it may not be directly decided in the S--- O--- case because of the intrastate flights, ~~that~~ our earlier decisions that corporate aircraft used only to transport company personnel from one state to another are not interstate commerce are wrong. Not only are the authorities from other states researched by John Abbott persuasive but it just does not appear we have any strong grounds for denying such flights as part of interstate commerce. There was some uneasiness with Mr. Jugum as to planes used to fly professional golfers from one state to another, a professional gambler from one state to another, or corporate personnel who might be travelling on company business that was not interstate business. Nevertheless, there appeared little sentiment for the position (dicta) taken in earlier Bob Anderson hearing reports (attached) that such corporate planes were never eligible for treatment used solely as interstate commerce.

M e m o r a n d u m**325.0009**

To: Donald J. Hennessy

From: John Abbott

Subject: S--- O--- of California
SP – XX-XXXXXX-010
Proposed Hearing Report

In his memo dated June 27, Gary Jugum asked me to respond to you regarding whether or not S--- O---'s company airplane is properly taxable, and if so, on what basis.

S--- O--- purchased the plane out of state and brought it into California on February 10, 1981, within 90 days after purchase. The flight logs for the next six months after February 10, 1981 indicate 131 days of use or storage in California and 49 days of use out of state. During this six month period, the plane made one in-state trip in California, and three in-state trips in Alaska.

I assume that the rest of the plane's trips were interstate, and that the primary if not sole purpose of all the trips, both in-state and interstate, was to transport S--- O---'s own employees on company business. I also assume that the company business purposes to which the flights relate were part of S--- O---'s interstate operations.

Regulation 1620(b)(2)(B) provides:

Use tax does not apply to property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.

Our audit staff's position is that Regulation 1620(b)(2)(B) cannot apply to privately used airplanes, and only applies to for-hire, common [or contract] carrier operations. S--- O---'s position is that this company plane was used in interstate commerce, and was continuously so used, and is entitled to the Regulation 1620(b)(2)(B) exemption.

In her preliminary hearing report dated June 8, Susan Wengel concluded that use tax applied to S--- O---'s purchase of the plane because, while the company plane was used in interstate commerce, it was not continuously so used. The in-state Alaska and California trips rendered the exemption inapplicable.

Jugum raises the question whether the section 6366 aircraft exemption might apply to this case. I think not, because S--- O--- is both a resident of California and used the aircraft in this state, and did not merely remove it from this state.

In my opinion, Wengel's conclusion is correct. S--- O---'s company plane, though not used as a common carrier and though used to transport company employees either primarily or exclusively, nevertheless qualifies as an instrument of S--- O---'s interstate commerce operations. However, S--- O--- did not use the plane continuously in interstate commerce, nor did S--- O--- base the plane more than half the time out of state in the six months following February 10, 1981.

I summarize the relevant case authority below.

In Protest of Woods Corp., CCH State Tax Reporter, Oklahoma §200-220 (Oklahoma Supreme Court, 1975), the taxpayer purchased an airplane from a California seller, who delivered it to the taxpayer in Montana. The taxpayer flew the airplane to Oklahoma, installed additional equipment there, and thereafter based the plane in Oklahoma where its principal office was located.

The taxpayer then used the plane almost exclusively in interstate flights, and used it extensively to transport its employees to other states for business purposes.

The court agreed with the taxpayer that the plane is an instrumentality in interstate commerce, but nevertheless found that there was a taxable moment of intrastate use in Oklahoma on which use tax could be imposed, because the plane had not commenced interstate operations at the time it arrived in Oklahoma, when its interstate transportation ended.

In Kentucky Fried Chicken v. Department of Revenue, CCH State Tax Reporter, Kentucky §201-268 (Kentucky Board of Tax Appeals, 1973), the taxpayer bought an airplane in North Carolina. The taxpayer flew the plane to Kentucky, where it was thereafter normally stored and serviced. Most of the plane's flights originated from and returned to Kentucky. A great majority of the flights were for the purpose of transporting the taxpayer's personnel to its operations in other states.

The Board held that despite the taxpayer's use of the plane in interstate commerce, use tax could be imposed because the plane was stored and used within the state.

In Vector Co. v. Benson, 491 S.W. 2d 612 (Tenn. Sup. Ct., 1973), the taxpayer purchased airplanes out of state, brought them to Tennessee, and thereafter based them in Tennessee. Most flights, but not all, were interstate, for the purpose of transporting company personnel on company business. The aircraft were also taxed as personalty in Tennessee.

The court held that the taxpayer owed used tax on the planes, because the planes were Tennessee property, having a local situs in Tennessee. The taxpayer was free to, and did, exercise dominion over the property by directing the operations of the planes from their Tennessee situs. The plane came to rest in Tennessee after delivery and before they began to be used in interstate commerce.

In Sundstrand Corp. v. Department of Revenue, 339 N.E. 2d 351 (Ill. App. Ct., 1975), the taxpayer brought into Illinois an airplane purchased out of state, and the next day put the plane into service transporting the taxpayer's personnel, guests, and customers, and occasionally freight, almost exclusively in long haul flights to points outside Illinois. The taxpayer kept the plane in Illinois between interstate flights for routine (but not major) maintenance and to await the next flight.

The court held that the taxpayer owed Illinois use tax. Relying on Southern Pacific Co. v. Gallagher, 306 U.S. 167 (1939), the court found that a taxable moment occurred after the delivery of the plane to Illinois and before it began to be consumed in interstate commerce. The court distinguished W. R. Grace & Co., *infra*, because, among other things, the Grace planes apparently became instruments of interstate commerce before they arrived in the taxing state.

In W. R. Grace & Co v. Comptroller, CCH State Tax Reported, Maryland §200-590, 258 A.2d 740 (Maryland Court of Appeals, 1969), the taxpayer based its two company airplanes in Maryland. Both planes were purchased out of state and serviced out of state. With one exception in a five-year period, all flights of both planes were interstate flights. The taxpayer used both planes regularly and exclusively to transport its personnel, its customers, and its property on company business.

The court agreed with the taxpayer that the planes were instruments of interstate commerce. The court held that (1) it did not matter that the taxpayer was not a common carrier and did not charge passengers a fare for the flights, in order to determine whether the taxpayer's planes were engaged interstate commerce, (2) the taxpayer did not "store" the planes in Maryland because "storage" for use tax purposes indicates the removal of the object from service, and (3) there was no taxable moment of purely local activity, unconnected with interstate commerce, except for the single intrastate flight of one of the planes in a five-year period. The court accordingly concluded that Maryland could not constitutionally impose use tax on the taxpayer.

I think the W. R. Grace case is distinguishable from our situation. First, the court in W. R. Grace used a definition of "storage" different from our definition. The court found that Maryland could not regard as a taxable use in Maryland the periods when the planes were on the ground there, because "storage" implied a removal from service, an not simply a period of time on the ground awaiting service. Thus the court counted only the plane's actual flights. We may certainly count ground time as well as flight time, because Revenue and Taxation Code Sections 6008 and 6009.1 include as storage "any keeping or retention in this state for any purpose..." with only certain exceptions not relevant here.

Second, the court found a single in-state flight in a five-year period to be an insufficient basis on which to impose use tax liability. In Regulation 1620, we use only a six-month period, during which even a single in-state use would be sufficient to base use tax liability.

Even if the Board can impose the use tax liability on S--- O--- under Regulation 1620, the tax must still meet the standards established by the U. S. Supreme Court in Complete Auto Transit v. Brady, 430 U.S. 274 (1977), to determine whether a state may constitutionally impose a tax on an in-state activity which is connected with interstate commerce. The court held that a state tax on an activity was permissible if it met all of the following tests:

- (1) there is a sufficient nexus between the activity and the taxing state;
- (2) the tax is fairly related to benefits and services provided by the taxing state;
- (3) the tax is not discriminatory against interstate commerce; i.e., does not single out interstate commerce for more burdensome treatment and;
- (4) the tax is fairly apportioned as between in-state and interstate business.

In my opinion, a use tax imposed on S--- O---'s company plane easily meets these tests. The first two tests are met by the fact that the use tax is only imposed on S--- O--- because it based the plane in California more than half the time in the first six months after the plane entered California. The third and fourth tests are met because section 6201 only imposes use tax liability on storage, use, or other consumption in California, and section 6406 provides a credit against use tax liability paid to another jurisdiction if the other jurisdiction's sales or use tax was imposed on the property before the California use tax was imposed. Together, these two sections assure that interstate commerce is not subjected to multiple taxation, and that the tax is imposed only on in-state activity.