STATE BOARD OF EQUALIZATION

August 10, 1971

Mr. J--- E. B---
Manager, Accounting Dept.
M--- N--- Company
XXX --- Street, --th Floor
--- ---, California XXXXX

SY -- XX XXXXXX

Dear Mr. B---:

This is with reference to the petition of M--- N--- Company, filed by Mr. L--- H---, and the hearing held on the matter last July 20 in --- ---.

The item protested was the assertion of use tax on new cargo containers which were purchased in Japan for use in foreign commerce and which were shipped to California before being used to carry cargo. The tax has been asserted on the empty containers when they arrived in California to await cargo for a return trip to Japan and other Far East points.

One argument made in support of exempting the containers was that the new empty containers being transported to California were in foreign commerce. One theory behind this agreement was the fact that at the time there was a trade imbalance of about 25 percent. This is to say that for every 100 containers leaving California for the Far East full of cargo, only about 75 returned with cargo; the other 25 came back empty. Thus, more containers were needed in California than in the Far East, and when the new containers were purchased there was not enough cargo available to cause them to come back loaded.

Mr. H--- wrote in the petition that the test for application of the use tax should not be whether a container is empty or full upon entering the state, but rather whether there is a purpose which is to be effected by the interstate commerce exemption. He wrote that this should be judged, not by some artificial standard, but by the usual business and industrial concepts. He cited 43 Ca. Jur. 388 as authority.

We believe the artificial standard would be to conclude that the containers were being used as instruments of interstate and foreign commerce when they were being transported new and empty to California to be loaded and placed in use carrying cargo flowing in foreign commerce. We looked at 43 Cal. Jur. 2d 388 and find that it relates to authorized uses of school buses under the Education Code. We do not see how it is relevant to when a cargo container is first placed in foreign commerce.

The containers, in our opinion, were not instruments in foreign commerce until they were first so used. The fact that they were being transported here new and empty to make possible outbound service does not dictate the conclusion that they were instruments of commerce when they were being transported to California.

There appears to be ample case law for taxing the use under conditions that are similar to those in the M--- container situation. For example:

> "A state tax on the storage and use of tangible personal property bought outside the state by a railroad company engaged in intrastate and interstate commerce, temporarily stored in the state for the purpose of protection until use, and intended for immediate or subsequent installation or use as a part of the interstate transportation facilities does not violate the commerce clause of the Federal Constitution, since the retention and installation of the property are intrastate taxable events, and there is a taxable moment when the property has reached the end of its interstate transportation and has notbbegun to be consumed in interstate operations of the railroad." Southern Pacific Co. v. Gallagher (1938) 306 U.S. 167.

> "A state use tax against a telephone and telegraph company upon the retention and installation of personal property purchased outside the state and shipped into the state for use in its plants and lines devoted to both interstate and intrastate commerce, which property consisted of equipment purchased on specific orders for installation at particular places, shipped to the company at the places of use and not held in warehouses in the state, and goods bought from time to time for holding as stand-by supplies to meet fluctuating demands and emergencies and to make repairs, does not violate the commerce clause of the Federal Constitution, since such retention and installation are rights of ownership in the taxing state, exercised after termination of the interstate shipment and before the use or consumption on the interstate system. Pacific Tel. & Tel. v. Gallagher (1938) 306 U.S. 180.

Note in the foregoing that the United States Supreme Court mentions the fact of ending interstate transportation of goods before they are used or consumed in the interstate operation. These cases involved the imposition of use tax on goods that ultimately were consumed or used in interstate operation. In the M--- case, there is a slight distinction but we are of the opinion that it does not

dictate a different result. In M--- we have the imposition of use tax on new unused property purchased in a foreign country and shipped to the United States in foreign commerce to await consumption in foreign commerce operations.

While the immunity of foreign commerce from the imposition of imposts and duties is not the same as the exemption of goods moving in interstate commerce, and while tests of constitutional validity under the commerce clause do not control the result of cases arising under the import clause, goods imported into the United States from a foreign country are not permanently exempted from state and local taxes. There must be a point of time when the prohibition ceases and the power of the state to tax commences. The immunity of imported goods is ended by their removal from the original package in which they are imported or by their use by the importer. Sugarman v. State Board of Equalization (1958) 51 Cal. 2d 361.

> "The tax imposed by Revenue and Taxation Code sections 6201 and 6202 is on the use of goods in California. It is sufficient that subsequent to the arrival in this state of a yacht constructed for plaintiff in Holland, its original package was removed and it was put to use in this state. Sugarman v. State Board of Equalization, supra.

Obviously, before the empty containers could be filled for use in foreign commerce, they had to have had the original package they came over in, if any, removed. At that instant, if not sooner, the tax liability would have arisen.

The cases make it clear that goods imported in interstate or foreign commerce are not immune to use tax and that the importation in and of itself, is not a use in interstate or foreign commerce.

Section 6395 of the Revenue and Taxation Code reads:

> "There are exempted from the computation of the amount of sales tax the gross receipts from sales of waterproof cargo containers under 20 feet in length, equipped with top-lift castings, suitable for shipboard use, or materials to become and ingredient or component part of such containers, which are rented to a lessee and removed from this state within 30 days by the lessee for subsequent use in interstate or foreign commerce outside this state and not returned to this state within six months thereafter."

The new unused containers leaving California that we are concerned with leave California as a general rule in less than thirty days but they return in less than six months either full or empty. Thus, had they been purchased from a retailer in California, they would have been subject to sales tax notwithstanding the fact that they might have qualified as to size, etc., under the statute.

The Use Tax Act of 1935 must be construed in the light of one purpose thereof, namely, to make the coverage of the tax complete to the end that the retail sales tax will not result in any unfair burden being placed upon local retailers engaged solely in intrastate commerce as compared with the case

where property is purchased for use or storage in California. The two taxes are complemental to each other with the aim of placing local retailers and their out-of-state competitors on equal footing. Chicago Bridge & Iron Co. v. Johnson (1941) 19 Cal. 2d 162.

It is the intent of the use tax merely to supplement the sales tax by imposing on those subject to it a tax burden equivalent to that of the sales tax with the same specific exemptions. The Atchison, Topeka & Santa Fe Railway Co. v. State Board of Equalization (1956) 139 Cal. App. 2d 411.

Summarily, it is concluded that the new empty cargo containers were not in foreign commerce use when they were en route to California, and they were used in California when they were readied and stored in stand-by awaiting cargo for the outbound trip. There is no constitutional exemption under the commerce or import clauses that prevents asserting the use tax on the containers, and asserting the use tax on them is placing local retailers of containers on an equal footing with their Japanese counterparts.

For the reasons and conclusions stated above, we must recommend that the petition be denied.

M--- N--- Company is entitled to a hearing before the Board under Section 6562. If, after considering our recommendation and the reasons for making it, M--- desires such a hearing a request must be filed in writing and must include the specific grounds on which a petition for Redetermination is founded.

Very truly yours,

Robert H. Anderson
Tax Counsel

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bc: --- --- – Dist. Admin.
Attached are two copies of the hearing report dated July 30, 19XX.