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Executive Director

November 19, 1999

T--- and S--- B---
XXXX --- Drive
--- ---, California XXXXX

Re: Purchase of a Vessel Delivered Outside of California's
Territorial Waters

Dear Mr. and Mrs. B---e:

This letter is in response to your letter to Ms. Patricia Hart Jorgensen of October 5, 1999, in which you state:

“We are purchasing a used boat, which is being delivered to us offshore. We believe we understand how to qualify for California Use Tax Exemption, but we would like to describe the details of the delivery. If the method of the delivery is incorrect, please advise us so that we may correct it.

“The broker, who represents the seller, will take us outside the three-mile marker on the boat that we are purchasing. We will not have control of the boat until we are outside California waters. When we reach international waters, over 3 miles off shore, he will pass title to us and notify the finance company and insurance company that the boat is now our financial responsibility. This will be documented in writing on letterhead, indicating the date, time and location (latitude and longitude) that the transaction occurred.

“Is it correct to have the broker, who represents the seller, take us on the boat as passengers? We can have an extra boat take us outside the state. However, it is very dangerous to transfer ourselves between boats in the ocean.

“After title of the boat has been transferred to us, we will return her to Alameda for approximately 7 to 10 days to provision her for a trip to Mexico. We plan on keeping it in Mexico for one year and then to the South Pacific, Panama and other places after I retire in two years. The boat may be returned to Alameda

from time to time. However, it will be in Mexico for more than 50% of the first 190 days of ownership.”

General Discussion:

Retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless the sale is exempt from taxation by statute. (Rev. & Tax. Code §§ 6051, 6275, 6283.) When sales tax does not apply, use tax, measured by the sales price, applies to the use of tangible personal property purchased from a retailer for the storage, use, or other consumption in California, unless the use is exempt from taxation by statute. (Rev. & Tax. Code §§ 6201, 6401, 6294.) Every person making a retail sale of a vessel is a retailer (Rev. & Tax. Code § 6275), and Regulation 1610, a copy of which is enclosed, explains that sales tax applies to a sale of a vessel by a person required to hold a seller’s permit from the Board by reason of the number, scope and character of its sales of vessels, and that use tax applies when the sale of a vessel is made by a person who is not so required to hold a seller’s permit, and the person storing, using or otherwise consuming the vessel is liable for the tax.

Unless explicitly agreed that title passes at an earlier time, or a bill of sale is delivered at an earlier time, a sale occurs at the time and place at which the retailer completes his or her performance with reference to the physical delivery of property, even though a document of title may later be delivered at a different place or time. (Regulation 1628(b)(3)(D).) The place of sale is the place where the property is physically located at the time the act constituting the sale takes place. (Rev. & Tax. Code § 6010.5, Reg. 1628(b)(4).) In order for the sale of a vessel to be considered made at a point outside of California, title must not have previously passed to the purchaser and the delivery of the vessel must occur more than three miles from any point on the California coast.

Revenue and Taxation Code section 6396, as explained by Regulation 1620(a)(3)(B), exempts from sales tax, the gross receipts from sales of tangible personal property which, pursuant to the contract of sale, is required to be shipped and is shipped to a point outside the state by the retailer by means of facilities operated by the retailer or by delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point. If title to the property passes to the purchaser at a point outside the state, or if for any other reason the sale occurs outside of this state, sales tax does not apply. (Reg. 1620(a)(1).) However, Regulation 1620(a)(3)(A) cautions that, regardless of the intent to deliver the property outside this state, “tax will apply if the property is diverted in transit to the purchaser or his representative in this state or for any other reason it is not delivered outside this state.”

Sales tax will not apply to the sale of a vessel if the retailer or its agent (i.e., a captain hired by the retailer) delivers the vessel to the purchaser outside of California, or if the retailer delivers the vessel by facilities of a common carrier, e.g., to a ship that is a common carrier

(which may be hired by the purchaser) where the vessel is placed on board the common carrier ship and then delivered to the purchaser outside the state (Reg. 1620(a)(3)(B)).

Title to a vessel will not pass outside the state and sales or use tax will apply to the sale if a person other than the retailer, or an agent acting on behalf of the retailer, delivers the vessel to the purchaser. If the purchaser or its agent hires a person to take the vessel outside of California, then the delivery of the vessel to this person in California (e.g., to the broker or to a captain hired by the purchaser or to any person other than the retailer or its agent) is a delivery to the purchaser's representative in California and tax applies to the sale.

If the retailer or its agent has possession and control of the vessel in taking the vessel from California to a point outside of California, and then gives possession and control of the vessel to the purchaser outside of California, the vessel will be regarded as delivered to the purchaser outside of California even if the purchaser is on board the vessel on the trip from California to a point outside of California, as long as the purchaser does nothing that could be construed as controlling the vessel, e.g. steering the vessel or acting in any way other than as a mere passenger. The purchaser may choose to travel to that point outside California in a separate vessel to conclusively demonstrate that he or she did not have possession or control of the vessel prior to delivery. Where the vessel will travel to out-of-state points following the delivery to the purchaser outside the state, a separate vessel may be required to return the retailer or its agent who delivered the vessel to the purchaser to California, since entry into the state to return the retailer or its agent to California is considered a use of the vessel in California.

A vessel delivered at a point outside of the state to a purchaser known by the retailer to be a resident of California is presumed to have been purchased from a retailer for storage, use or other consumption in California and stored, used or otherwise consumed in California. (Rev. & Tax. Code § 6247, Reg. 1620(b)(3).) To controvert this presumption, the vendor should timely obtain and retain a statement in writing, signed by the purchaser, or his or her authorized representative, that the property was purchased for use at a designated point or points outside of the state. Similar to an exemption certificate, the written statement will not excuse a retailer from liability if it is not taken in good faith. Such statements will be disregarded if evidence satisfactory to the Board demonstrates that the retailer knew or should have known that the vessel was purchased for use in this state.

Notwithstanding the purchaser's submission of a signed statement which is accepted in good faith, the purchaser will be liable for use tax if the vessel is deemed to have been purchased for use in this state. Regulation 1620(b)(3) states:

“[P]roperty purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California. When the property is first functionally used outside of California, the property will nevertheless be presumed to have been purchased for use in this state if it is brought into California within 90 days after

its purchase, unless the property is used or stored outside of California one-half or more of the time during the six month period immediately following its entry into this state. Prior out-of-state use in excess of 90 days from the date of purchase to the date of entry into California, exclusive of any time of shipment to California or time of storage for shipment to California, will be accepted as proof of an intent that the property was not purchased for use in California. Prior out-of-state use in excess of 90 days from the date of purchase to the date of entry into California, exclusive of any time of shipment to California, or time of storage for shipment to California, will be accepted as proof of an intent that the property was not purchased for use in California.”

Even if a vessel is delivered outside of California, a vessel first functionally used in California is regarded as purchased for use in California and is subject to tax. A commercial vessel is regarded as first functionally used when used for the commercial purposes for which it is designed, while a pleasure vessel, such as a small motor boat, may be regarded as first functionally used on its first trip into California.¹

¹ Sales and Use Tax Annotation 325.0013.200 (8/10/92) describes when vehicles, vessels and aircraft are regarded as functionally used as follows:

“An opinion was requested regarding the legal department's position on the first functional use test as it applies to vehicles, vessels, and aircraft.

“After a review of the Revenue and Taxation Code, Sales and Use Tax Regulations, and various court cases, including *American Airlines Inc. v. State Board of Equalization* (1963) 216 Cal.App.2d 180, it was concluded that if a vehicle or vessel is designed for commercial carriage, e.g., a bus, a tractor-trailer, or a sightseeing boat, the first functional use will be outside California if passengers are boarded or cargo is loaded onto the vehicle or vessel outside of California. If such vehicle or vessel is deadheaded into California, the first functional use will be in California unless the vehicle or vessel is brought to California to fulfill an existing lease or charter, or to pick up a specific load of cargo or group of passengers. The same applies to aircraft, though in some instances the purchase of such aircraft will be exempt under section 6366 or 6366.1.

“Vehicles, vessels and aircraft which are purchased for commercial purposes and used for commercial purposes are not "functionally used" until used for the commercial purpose for which they were designed.

“With respect to vehicles, vessels, and aircraft designed for personal use, such as a passenger vehicle as defined in Vehicle Code section 465, a small motor boat, or a small plane, the first trip or flight into California is a functional use outside of California without regard to who drives or pilots the vehicle, vessel, or aircraft or to whether it is carrying passengers or cargo.

“Finally, regardless of what purpose the vehicle, vessel, or aircraft was designed for, the first functional use of such items will be in California if they are not brought into California under their own power and they have not otherwise been functionally used outside of California.”

A vessel delivered and first functionally used outside of California, that is used outside of California in excess of 90 days from the date of purchase to the date of entry into California (exclusive of time of shipment or storage for shipment to California), is not subject to tax. This 90-day test period is used to ascertain intent, and while the vessel does not have to be functionally used during the entire time of the test period, it has to be used, not just stored, during the 90-day test period and any period of storage for shipment to California is excluded. (See Sales and Use Tax Annot. 325.0220 (7/2/96).) In determining whether the property was used outside of California during the 90-day test period, the focus is whether the use outside of the state is comparable to the use to be made in California. For example, in the case of a vessel purchased for pleasure sailing, if the vessel, once it is brought into California, is used every other weekend, then a comparable use must be established during the 90-day test period in which the vessel is outside California.

A vessel delivered and first functionally used outside of California that enters California within the 90-day period is subject to tax, unless the vessel is used or stored outside of California one-half or more of the time during the six-month period immediately following its entry into California.²

To support the purchaser's claim that its purchase is not subject to tax, the purchaser should retain documentation to demonstrate that the vessel was not purchased for use in California, including, but not limited to, a copy of the sales agreement showing that title is not to pass to the purchaser before delivery; bill of sale showing title transferring on or after delivery; documentation showing the retailer delivered the vessel to the purchaser outside of California, e.g. entries in the ship's log detailing the transfer, GPS longitude and latitude print-outs, GPS data and/or Loran coordinates recorded in the ship's log or in some other manner, statements of witnesses present at the transfer signed under penalty of perjury, photos of three-mile buoy, and photos of the transfer taking place outside of California; any and all documents and/or receipts showing the first functional use outside of California; any and all documents and/or receipts either (a) substantiating use outside of California for a period in excess of the 90-day period; or (b) if the vessel enters California within the 90-day period, substantiating storage or use outside of California for one-half or more of the six-month period immediately following entry into California, e.g. ship's log, fuel receipts, docking receipts, slip rental receipts, insurance contracts, credit card bills, invoices for repair and maintenance, and any other records or receipts such as for food purchases to show the dates and periods that the vessel was in and out of California.

² The test period is usually expressed in days, and the actual number of days in the six-month period are used, which, depending on the number of days in the months in the six-month period, may or may not be 180 days. For example, the six-month period from July 1 through December 31 has four 31-day months and two 30-day months for a 184-day six-month period. Fractions of a day may be used in this calculation of use or storage inside or outside of California so long as they are used consistently over the test period.

Specific Discussion:

For the purposes of this letter, I assume that you are purchasing a pleasure boat, not a commercial vessel, and that delivery will be made by the retailer, not by facilities of a common carrier. I further assume that you and the retailer do not agree that title passes before delivery, and title in fact does not transfer to you before physical delivery of the vessel, e.g. by a close of escrow in which the bill of sale is delivered to you before the vessel is delivered to you.

From the information you provided, we cannot determine whether the "seller's broker" is acting on the seller's behalf or on your behalf in taking the boat from California to a point outside of California. The broker representing the seller in negotiating the sale of the boat does not necessarily represent the seller when taking the boat from California to a point outside of California. If the seller merely authorizes the sale of the boat and does not hire the broker to deliver the boat to you outside of California, but instead you arrange with the broker to so "deliver" the boat to you, the broker then would be acting as your agent or representative. Accordingly, the delivery of the boat in California to the broker as your representative would be subject to tax. If the broker were in fact acting as the agent for the seller and if the broker, as the seller's agent, had possession and control of the boat in taking the vessel outside of California, and only gave possession control of the boat to you outside of California, the vessel would be regarded as delivered to you outside of California, even if you were aboard the boat on the trip from California to a point outside of California, as long as you were on board as a mere passenger with no possession or control.

Even if the boat were to be delivered to you outside of California, you state that you plan to immediately return with the boat to California. Assuming that your return trip of this pleasure boat qualifies as its first functional use outside California, its return to California on the day of its purchase causes the boat to be presumed to have been purchased for use in California and therefore subject to tax, unless used or stored outside of California one-half or more of the time during the six-month period immediately following its entry.

Your keeping the boat in Mexico over 50 percent of the first 190 days of ownership may not satisfy the requirement that the vessel be used or stored outside of California one-half or more of the six-month period immediately following its entry. The six-month period is the six months following entry into California, not the first six months of ownership. Even if the vessel were to enter California on the day you became the owner, the test period is six months following entry, not 190 days. If the vessel were in California the first 94 days following entry and then in Mexico the next 96 days, and the six-month period following entry was 184 days, then the vessel would not have been used or stored outside the state one-half or more of the time following entry, and its use would be subject to tax.

You have not provided sufficient information for me to conclude that your purchase of the boat is not subject to tax. This letter therefore does not come within the Revenue and

Taxation Code section 6596 and Regulation 1705 enclosed, which sets forth circumstances under which a taxpayer may be relieved of liability for taxes when relying on a written response to a taxpayer's request for an opinion.

If you have any further questions or wish to provide further information, please feel free to write again.

Very truly yours,

Janice L. Thurston
Senior Tax Counsel

JLT/cmm
Enclosures (Regs. 1610 & 1705,
Rev. & Tax. Code § 6596)

cc: --- District Administrator (--)