STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-5550

December 6, 1991

Mr. E--- F. C---
E--- & Y---
XXX --- ---, Suite XXX
---, CA XXXXX

Dear Mr. C---:

This is in response to your letter dated October 24, 1991 which requests a ruling on the application of tax to the sale and use of certain cargo containers. Initially, I note that the staff does not issue rulings. Revenue and Taxation Code section 6596 provides the only basis for the Board to relieve a person of tax if that person has relied on incorrect advice from the Board. To come within the provisions of section 6596, the Board's advice must be in writing in response to a written request for advice which discloses all relevant facts, including the identity of the parties. Since your client is not identified, this opinion does not come within the provisions of section 6596.

Your client, X, owns a maquiladora facility, M, in Mexico which assembles oceangoing cargo containers for use in transporting freight in ships. X acquires tangible personal property in California to be incorporated into the containers by M and retains title to that property throughout the manufacture process by M in Mexico. X then sells the containers to a leasing company, L, and as instructed by L, directs M to send the containers directly to L in California. At the time L purchases the containers from X, L has already leased them to a specific lessee. Upon delivery to that lessee, the containers are filled with freight and then loaded onto ships having foreign destinations. The containers leave California within 30 days after the date of delivery to M.

Revenue and Taxation Code section 6388.6 provides an exemption with respect to cargo containers, as defined therein, when the cargo container is purchased for use outside California, delivered by an instate manufacturer to the purchaser in this state, and is removed from California within 30 days after the date of delivery. X believes that it qualifies as an instate manufacturer within the meaning of section 6388.6 and is therefore entitled to the exemption. It appears that the argument that X is an instate manufacturer must be based on its acquisition of raw materials in California. However, a person who simply acquires raw materials in California and thereafter manufacturers property outside California is not an instate manufacturer within the meaning of section 6388.6 "Instate" modifies "manufacturer" in this provision, and the two terms may not be separated for purposes of qualifying for the exemption. That is, only a person who actually

manufacturers the property instate qualifies as an instate manufacturer. Since X does not manufacture the containers in California, the section 6388.6 exemption does not apply.

X also believes that the sales in question qualify as exempt interstate commerce transactions since the containers are delivered to L from outside the state and, as soon as they are filled with freight, they leave the state for use exclusively in interstate and foreign commerce.

Revenue and Taxation Code section 6023 defines mobile transportation equipment (MTE) to include reusable cargo shipping containers. Under subdivision (g)(4) of section 6006 and subdivision of (e)(4) of section 6010, the lease of MTE such as cargo containers for use in transportation of persons or property in excluded from the definition of "sale" and "purchase." This means that a person purchasing MTE for such purposes is a consumer of that MTE. L is purchasing cargo containers which are MTE in order to lease that MTE for use in transportation of property. Therefore, L is the consumer of the cargo containers and X is making retail sales of those containers to L. If L purchases those containers for use in California, L's use of the property is subject to use tax.

Subdivision (b)(3) of Regulation 1628 explains when property is regarded as having been purchased for use in California. If the property is purchased outside California but is first functionally used in California, the property is regarded as having been purchased for use in this state. If the property is first functionally used outside California, the property is nevertheless 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 California one-half or more of the time during the six-month period immediately following its entry into California. This is explained further in Business Taxes Law Guide Annotation 570.0430 (1/7/74, 3/23/84). That annotation sets forth the following four tests to determine whether property purchased outside the state and used in interstate commerce is regarded as having been purchased for taxable use in California:

1. If first functionally used in California, it is presumed that the property was purchased for use in California and that use tax applies.

2. If the property is first functionally used outside California but comes into California within 90 days from the date of purchase, it is presumed that the property was purchased for use in California unless tests 3 or 4 call for a different result.

3. If the property is first functionally used outside California, brought into California within 90 days from the date of purchase, and then used more than one-half the next six-months inside California, it is presumed that the property was purchased for use in California and that the use tax applies unless test 4 calls for a different result.

4. If the property is otherwise subject to tax under test 3, no tax will apply if the property is first functionally used in interstate commerce outside California, enters California in the course of such interstate use, and then is used continuously in interstate commerce while in California during a test period of the six-months after the property first enters California.

The containers about which you inquire obviously enter California within 90 days of the date of purchase by L. Therefore, it is presumed that the property is purchased for use in California. If the containers are not regarded as being first functionally used by L in California, then it appears that either test 3 or test 4, or both, would be satisfied and the property would not be regarded as having been purchased for taxable use in California. Thus, the conclusion as to whether tax applies depends upon whether the property is first functionally used by L in California. If so, tax applies.

As noted above, the cargo containers are MTE and L is regarded as the consumer. L purchases the cargo containers for lease to a lessee and first leases that property to the lessee in California. The lessee first uses the containers when they are filled in California. We conclude that the containers are first functionally used in California and that L is therefore regarded as purchasing the property for use in California. Use tax applies to that purchase measured by the purchase price of the containers unless L makes a timely election to pay its tax liability measured by fair rental value. (See Reg. 1661.) If it makes such an election, tax applies to the fair rental value whether the property is inside or outside California.

If you have further questions, feel free to write again.

Sincerely,

David E. Levine
Senior Tax Counsel

DHL:cl
0524E

bc: --- District Administrator