

**STATE BOARD OF EQUALIZATION**

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 Interim Executive Director

January 26, 2004

Mr. R--- D. A---, Esq.

S---

XXXX --- ---

--- ---, CA XXXXX-XXXX

**Re: S---**

**SR -- XX-XXXXXX**

Dear Mr. A---:

This is to acknowledge receipt of your correspondence dated November 12, 2003, addressed to Mr. Larry Bergkamp of the State Board of Equalization's (Board) Public Information and Administration Section regarding the above-referenced taxpayer. Your letter has been referred to the Board's Legal Division and assigned to me for reply.

In relevant part, you write:

"The S--- (S---) hereby requests that the Board of Equalization (BOE) authorize S--- to issue exemption certificates to its vendor of light rail vehicles, K--- I--- LLP,<sup>1</sup> so that in future sales of rolling stock the vendor will not be obligated to collect sales tax [sic<sup>2</sup>].

<sup>1</sup> K--- I--- LLP, if such an entity exists, is not registered with our agency; however, K--- I--- LLC is (Account Number: SR -- XX-XXXXXX).

<sup>2</sup> Sales tax is imposed on the retailer who may collect reimbursement from the customer if the contract of sale so provides. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.) Thus, as to transactions subject to sales tax, the retailer is not obligated to collect sales tax reimbursement from the customer. As discussed below, transactions subject to use tax are governed by different rules.

“The standard exemption certificates on the BOE website are all based on various exemptions under California statutory law. The sales for which S--- wishes to issue the certificates are all exempt pursuant to the federal law known as the 4-R Act (The Railroad Revitalization and Regulatory Reform Act of 1976, Section 306, Pub. L. 94-210, 90 Stat. 31 (1976), now codified at 49 U.S.C. §11501(b)(4).) There is no standard form for this exemption, although it has been recognized both by the federal courts and the BOE as a valid exemption (see enclosed memorandum opinion of the BOE for citations). When I spoke to you [i.e., Mr. Bergkamp] last month, you advised S--- to submit the documents that establish it is entitled to the exemption, and said that [the] BOE would then review them and upon finding them satisfactory would provide authorization to S--- to issue the exemption certificates to its vendor. S--- is hereby submitting the documents as requested.

“Enclosed are:

- A factual history and letter from C--- S---, Esq.[.] regarding S---’s status with the federal Surface Transportation Board (STB), establishing that S--- is providing transportation subject to the jurisdiction of the STB;
- A copy of the Trackage Rights Agreement between S--- and the [Z] Railroad (Z) which gave rise to STB jurisdiction; and
- A copy of the memorandum decision of the BOE in the matter labeled *Bombardier, Inc.*, providing the legal authority and precedent for the exemption.

“[¶] . . . [¶]

“S--- seeks to issue exemptions certificates for future sales of rail vehicles only, not for spare parts or other goods or services. The light rail vehicles will be used on the track acquired from [Z] in the transaction documented herein. We realize that refund of past sales taxes paid must be applied for by our vendor in a separate process. We intend to pursue that process simultaneously.

“Based on the above, we hereby request that the BOE grant S--- authorization to issue exemption certificates to K--- I--- LLP,<sup>3</sup> or any subsequent vendor, for the purchase of light rail vehicles to be used on the former [Z] M--- Line so long as the enclosed Trackage Rights Agreement is in effect.”

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<sup>3</sup> See footnote 1.

### DISCUSSION

As a starting point, California imposes a sales tax measured by a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, § 6051.) It is presumed that gross receipts from a particular sale of tangible personal property are subject to tax, unless the seller can establish either that the sale was not a retail transaction or that the sale is subject to an exemption. (Rev. & Tax. Code, § 6091.) As to California retail transactions, valid exemption certificates taken in good faith can relieve a seller from liability for sales tax. (Rev. & Tax. Code, § 6421.) However, if the purchaser in question puts the subject property to a nonconforming use (i.e., a use that is inconsistent with the representations made in the tendered exemption certificate), then the purchaser will be liable for sales tax on the relevant transaction. (Rev. & Tax. Code, § 6421.)

When sales tax does not apply, use tax is imposed measured by the sales price of property purchased from a retailer for storage, use or other consumption in California. (Rev. & Tax. Code, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code, § 6202.) A retailer engaged in business in this state is required to collect this tax from its customers and remit it to the Board. (Rev. & Tax. Code, §§ 6203, 6204.)

As explained below, the documents you have presented for consideration do not disclose the existence of the necessary factual and legal bases for establishing that the S--- (S---) would be entitled to issue exemption certificates to retailers of light rail vehicles under Revenue and Taxation Code section (Section) 6352, which allows an exemption for sales of tangible personal property that California is prohibited from taxing under the laws of the United States. The federal law at issue, the Railroad Revitalization and Regulatory Reform Act (the 4-R Act), was interpreted by the Board in *Bombardier, Inc.*, a memorandum opinion published by order of the Board on September 1, 1999 (hereafter *Bombardier*).

In *Bombardier*, the Board held that the 4-R Act's protection from discrimination operates on behalf of commuter rail carriers operating on portions of the interstate rail system inside California because such commuter rail carriers are "subject to the jurisdiction" of the federal Surface Transportation Board (STB). In other words, under the Board's holding in *Bombardier*, a rail carrier cannot qualify for a "4-R Act" exemption under Section 6352 unless, among other things, the rail carrier seeking the exemption is presently operating on a portion of the interstate rail system that is subject to the jurisdiction of the STB.

S--- has not provided documentation sufficient to establish that it is an entity entitled to the protection from discrimination provided by the 4-R Act. First, S--- has not provided an informal opinion from the STB (i.e., the same form of evidence that the Board accepted in *Bombardier*) to establish that S--- is a rail carrier subject to the jurisdiction of the STB.<sup>4</sup> Second, S--- has not established that it is currently providing commuter rail service on and over the portion of track at issue (hereafter the M--- line) that S--- allegedly purchased from the [Z] Railroad Company [Z].

The Trackage Rights Agreement (TRA) between S--- and [Z], which is part of the documentation S--- provided for consideration, indicates that S--- acquired the M--- line from [Z] and simultaneously granted back to [Z] the exclusive right to use the M--- line. At most, the TRA indicates that S--- has the right to initiate a process whereby S--- *might eventually* be able to operate as a commuter rail service on and over the M--- line. Indeed, your November 12, 2003, letter only ambiguously states that the light rail vehicles in question “will be used” (i.e., at some indefinite time in the future) on the M--- line.

For example, Section 2.1 of the Trackage Rights Agreement states, in part, that:

“[S---] hereby grants to [Z] the exclusive right, and [Z] shall have the exclusive right and obligation, to provide Freight Rail Service on and over the [M--- line], by itself or through its designees. Subject to the terms and conditions of this Agreement, [Z] shall also have the exclusive right to use and control the [M--- line] for Freight Rail Service; provided, however, that [S---] may use the [M--- line] for rail passenger service *subject to the parties’* [sic] *first having entered into* (i) a mutually acceptable operating agreement, the terms of which will assure the continued Functionality of the Freight Rail Service, (ii) a mutually acceptable amendment to this Agreement contemplating the impacts of shared track operations on the terms hereof, and (iii) such other third[-]party agreement(s), if any as may be required.” (Emphasis supplied.)

S--- has not provided documentation establishing that the three conditions specified in Section 2.1 of the Trackage Rights Agreement, which must be met before S--- would be contractually permitted to operate on and over the M--- line, have been satisfied. Additionally, Section 9.1.1 of the Trackage Rights Agreement indicates that [Z] would need to receive approval from the STB before S--- could begin using the M--- line for commuter rail service. Again, no documentation establishing such approval from the STB has been submitted. Most importantly, putting issues of authorization aside, S--- has submitted no documentation showing that S--- is now actually using the M--- line to provide commuter rail service. In short, nothing in the documentary materials under consideration demonstrates that S--- is presently providing authorized commuter rail service on and over the M--- line.

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<sup>4</sup> I understand that S--- believes that the STB may currently be trying to discourage requests for informal opinions. However, nothing in the documentation S--- has submitted indicates that the STB no longer issues such opinions. For purposes of verifying that S--- is a rail carrier subject to the jurisdiction of the STB, S---’s submission of a legal opinion authored by counsel hired by S--- cannot substitute for the opinion of the STB.

In sum, S--- has not yet shown that it is similarly situated to the claimant in *Bombardier*. Accordingly, S--- should not issue exemption certificates to its vendors of light rail vehicles. In the event that S--- were to submit additional documentary evidence that, upon review, verifies that S--- is subject to the jurisdiction of the STB and that S--- is presently providing authorized commuter rail service on and over the M--- line, I would be happy to issue a revised opinion.

Sincerely,

Randy M. Ferris  
Senior Tax Counsel

RMF/bb

cc: Mr. Larry Bergkamp (MIC: 44)  
Mr. Jerry Cornelius (MIC: 44)  
Mr. James C. Kuhl, Sr. MIC: 40)  
--- --- District Administrator (--)