

M e m o r a n d u m**500.0200**

To: _____ Date: February 16, 1965

From: E. H. Stetson

Subject:

Upon review of your memo of January 18, 1965, and the audit report attached, it is my opinion that the sale of the "Ship" to "X" is a taxable transaction. I base this conclusion upon the auditor's comments indicating that the above-referenced taxpayer did not sell all or substantially all of its tangible assets held or used in a selling activity, and made sales sufficient in number, scope and character to constitute it a retailer.

The taxpayer's argument that the sale was to a wholly owned subsidiary and is, thus, not a sale, overlooks the holding of the California Supreme Court in Northwestern Pacific Railroad Co. v. State Board of Equalization, 21 Cal. 2d 524, and also the requirement of Section 6006.5(b) that for an occasional sale to exist there must be a transfer of all or substantially all of the property in addition to the real or ultimate ownership remaining substantially unchanged after the transfer. The watercraft exemption appears clearly to be inapplicable in view of the fact that the purchaser is not a carrier, but uses the watercraft in a lease business.

With respect to the purchase of cargo containers from "A", I am not too clear as to the facts either from the auditor's comments or the taxpayer's statement. It appears, however, that the containers are used for land transportation, as well as water transportation and, therefore, the watercraft exemption does not apply. This was the position we took in a controversy with "B" over the sale to that company of certain cargo containers used for both land and water transportation. See my letters of August 13, 1958 and November 26, 1958 to "C", tabbed in the attached file. Whether the facts are parallel is not entirely clear, but it appears that probably the same principle governs.

The statement of the taxpayer in the letter of June 2, 1964 to the Board's New York office, does not make it clear that the containers are used to transport cargo overland, although the inference I draw is that there was such a use of the containers. The exemption is claimed under Section 6385, but at the same time a statement is made that the containers were shipped by the seller via the facilities of the purchasing carrier under a bill of lading to an out-of-state point.

H-R Truck & Equipment Co. v. State Board of Equalization, 166 Cal. App. 2d 378, is cited in support of the claim of exemption even though the cargo containers were used to transport cargo for hire by the purchasing carrier on the initial transportation of the containers to the out-of-state destination. Our claim in that case was, however, against the seller of the trucks who took an exemption certificate from the purchaser, whereas in the present case, liability is asserted against the user of the containers who gave an exemption certificate. Pertinent is the following language from the H-R opinion:

"Assuming that exempt status had been achieved by the dealings between the truck company and Navajo, the action of Navajo with respect to hauling payloads while engaged in transporting out of state the objects of sale could not affect the interest of the truck company, it not appearing that it had any knowledge, notice or responsibility for the conduct of Navajo. It is not Navajo that seeks exemption. The only evidence on the subject is that these actions of Navajo here relied upon by respondent as resulting in the truck company losing its exempt status is that the truck company did not know of these things until some four years after they occurred. Under these circumstances the truck company cannot be charged a tax by reason of this subsequent conduct of Navajo."

In our opinion the H-R decision did not hold that a claim against the purchaser would not be valid. The actual holding appears to be based upon the lack of knowledge of the seller H-R that its customer Navajo hauled payloads in the vehicles in question. We think that where the purchaser is the taxpayer, as in the present case, his action in using the containers for hauling payloads may well result in his loss of the exemption which was granted to the vendor, apparently, solely because the vendor had no knowledge and was not responsible for the conduct of the purchaser. Here the purchaser had knowledge of its activity, which may well be sufficient to cause it to lose the exemption, assuming it to be otherwise applicable.