

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

**570.0590**

To : Mr. Joe Nanut – MIC:30

Date: March 6, 2003

From : Sharon Jarvis, Supervising Tax Counsel  
Legal Department – MIC:82

Telephone: (916) 324-2634

Subject: [M]  
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I am responding to your memorandum dated October 18, 2002, to Chief Counsel Timothy Boyer concerning the above-named taxpayer and its vessel “O.” You refer to Mr. Boyer’s May 31, 2002, memorandum on the subject of Regulation 1620 and first functional use, and ask whether the first functional use of “O” occurred when the vessel was first raced solo from the East Coast of the United States in the “Around Alone” solo race around the world.

**Facts**

The information you provided indicates the following facts. The vessel was built in Portland, Oregon. On April 7, 2001, the vessel was delivered to the taxpayer in Portland, and on April 14, 2001, the vessel sailed to Oakland, California. On April 19, 2001, the vessel was featured at the 2001 Pacific Sail Exposition in Oakland. This appearance and other instances referred to on the taxpayer’s website indicate that the vessel made various appearances at boat shows and other events in California for publicity purposes in order to raise funds to finish equipping the vessel and to gather financial sponsors for the "Around Alone” race. While in California, the vessel was tested, refined and raced in at least five crewed races, including the OYRA Farallones Race on May 12, 2001, and the Windjammers Race on September 3, 2001. It also appears that the taxpayer conducted “classroom seminars” for young people, which included trips on the “O.” On August 22, 2001, the vessel made its first solo trial run, a 300-mile sail off the California coast.

On February 23, 2002, over ten months after it first entered California, the vessel departed for Mexico. It raced in the San Diego to Puerto Vallarta Race, arriving in Puerto Vallarta, Mexico on March 4, 2002. Later in March, the boat apparently departed from Mexico on its way to the East Coast of the United States via the Panama Canal, Antigua (where it raced in the Antigua Sailing Week), and Charleston. To date, the vessel has not returned to California.

**Discussion**

The taxpayer asserts that the first functional use of the vessel only occurred when the vessel was raced solo for the first time from the East Coast of the United States in the "Around Alone" race. The taxpayer contends that this is because the vessel was created specifically to be sailed around the world by one person in the "Around Alone" solo sailing race and is not suitable for recreational sailing or for coastal yacht racing. In other words, the taxpayer asserts that it does not owe California sales or use tax because no functional use was made of the vessel in this state. To be consistent with this, the argument must also be that no functional use was made of the vessel when it was sailed under its own power from Portland, Oregon to Oakland, California. (If the vessel were found to have been functionally used in either instance, it would have been functionally used in the other.)

As you know, the relevant regulation in determining whether tax applies is Regulation 1620. In that regard, Mr. Boyer's May 31, 2002, memorandum states:

"Subdivision (b)(3) of Regulation 1620 sets forth the basic rule that 'property 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.' That is, if property purchased outside California is functionally used in this state, no further analysis is required: the property is regarded as having been purchased for use in this state, and tax applies to that use without regard to later use (whether inside California, outside California, in interstate commerce, or any combination thereof). On the other hand, if the property is first functionally used outside this state, the additional tests set forth in Regulation 1620 must be applied to determine if the property was purchased for use in this state, and if so, whether that use is an exempt use in interstate commerce.

"The determination of where the property is first functionally used is thus critical to the question of whether tax applies. Subdivision (b)(3) of Regulation 1620 guides this determination by specifying that 'functional use' means use for the purposes for which the property was designed."

Thus, in order to determine *where* the sailboat "O" was first functionally used, we must first determine *what* the functional use of the boat is, i.e., for what purpose was the sailboat designed? The May 31, 2002, Boyer memorandum goes into considerable detail in analyzing whether certain vehicles, vessels, and aircraft are designed for commercial or personal use. Under that analysis, a sailboat that is designed to carry commercial passengers or cargo, such as a brigantine or a multi-masted schooner, would be viewed as first functionally used when it first boarded passengers or cargo, or when it was headed to a location to pick up a specific load of passengers or cargo. Clearly, a racing sailboat is not designed for the commercial carriage of passengers or cargo. Rather, its functional use is to sail, just as an automobile's functional use is to drive. Moreover, to conclude that a sailboat such as the "O" is not functionally used until it is raced in a solo around the world race, is too restrictive an application of the first functional use test when we consider that the vessel actually was used for a number of other purposes before it ever participated in the "Around Alone" solo race. Those uses included, but were not limited to,

crewed trips from Oregon to California, from California to Mexico, and from Mexico to the East Coast by way of Antigua and Charleston; crewed races; and exhibitions of the vessel for publicity and fundraising purposes.

For the above reasons, we conclude that the use for which the vessel was designed is to sail. Therefore, when the "O" was delivered to the taxpayer in Portland, Oregon and sailed from there to California, its first functional use was in Oregon.

Since we have determined that the first functional use was outside of California, we must next apply the additional tests set forth in Regulation 1620 to determine whether the sailboat was purchased for use in this state. The applicable test is stated in Regulation 1620(b)(4):

"(4) PURCHASE FOR USE IN THIS STATE – VEHICLES, VESSELS AND AIRCRAFT. A vehicle, vessel or aircraft 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 vehicle, vessel or aircraft is in California. When the vehicle, vessel or aircraft is first functionally used outside California, the vehicle, vessel or aircraft 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, exclusive of any time of shipment to California or time of storage for shipment to California, unless:

"(A) **Physically Located Outside California.** Use tax will not apply if the vehicle, vessel or aircraft is used, stored, or both used and stored outside of California one-half or more of the time during the six-month period immediately following its entry into this state."

Under the bright-line test, above, the sailboat is presumed to have been purchased for use in California because its first functional use was outside of California but it entered California within 90 days after its purchase. Since it was brought into California within 90 days after purchase, the next test is whether the sailboat was used in California for more than one-half of the six-month period immediately following its entry into this state. The vessel was in California for over ten months following its entry into the state. Since there is no indication that the vessel was outside of this state for any length of time during the six months following its entry, the facts indicate that the boat was used in California more than one-half of the six-month period following its entry. The uses in this state included appearances of the sailboat at events for publicity and fundraising purposes, taking various groups and persons out on the vessel, crewed and solo sailing, and sailing in races.

In conclusion, the facts provided indicate that the vessel was first functionally used outside of California, but was purchased for use in this state and is subject to use tax.