STATE BOARD OF EQUALIZATION

July 15, 1964

"C"

This is in reference to the petition for redetermination of the tax liability assessed against "C" in a determination dated July 9, 1963. The petitioner has objected to the tax only insofar as it relates to spare parts (flight equipment) installed on aircraft in California.

In brief, "C" is a public corporation formed by a law of [a foreign government]. The corporation is managed by a board of directors appointed by the _____ Cabinet and is subject to the general control of the Minister of _____. The _____ government is said to own _____ percent of the capitol stock.

"C" operates air routes throughout the world. Flights between _____ and Los Angeles are made under a foreign air carrier permit issued by the Civil Aeronautics Board. In order to comply with the requirements of the CAB and the _____ aeronautic authorities as well as to operate its aircraft safely and efficiently, "C" must maintain at its station is Los Angeles a certain number of spare parts, such as radio equipment, tires, and other component parts of aircraft. During the period in question, these parts were originally shipped and delivered to "C" at its main base at _____. They were purchased for use on aircraft as the occasion required.

It is contended that the imposition of tax on the storage, use or other consumption in this state of the spare parts shipped to Los Angeles is improper for the following reasons:

1. "C" is an instrumentality of the _____ government;

2. "C" is exempt from tax by treaty and by the laws of comity;

3. The _____ and the subdivisions thereof do not impose use taxes on similar used by United States international air carriers operating in _____;

4. The tax is prohibited by the commerce clause of the United States Constitution and by Section 6352 of the California Revenue and Taxation Code;

5. The spare parts were not purchased "for storage, use or other consumption in this State" within the meaning of Section 6201 of the California Revenue and Taxation Code.

We will discuss the latter point before considering the broader constitutional issues.

In American Airlines, Inc. v. State Board of Equalization, 216 Cal. App. 2d 180 (1963), the court decided the same question in favor of the Board on facts parallel to those present here. American, an airline operating in interstate and foreign commerce, protested an assessment of use tax on the

purchase price of new engines and propellers and on the purchase price of parts incorporated into overhauled and repaired equipment shipped into California and installed here. At the time the items were purchased, the company had not determined at what particular station any particular engine or propeller, or any particular repaired item, would be installed. The court held, nevertheless, that the equipment had been purchased for use in California within the meaning of section 6203, since it was contemplated that some of the units would be stored and installed here, and since, in fact, certain of the items were committed to their functional purpose in California.

The court quoted extensively from Chicago Bridge & Iron Co. v. Johnson, 19 Cal. 2d 162, wherein the California Supreme Court held that certain materials were purchased for storage, use or other consumption in this state, even though they were not designated for California use at the time of purchase, but were purchased for such use as the taxpayer's business might require. The Supreme Court had reasoned as follows:

> "While it is true that (the materials) were not acquired with the express purpose of performing any specified contract or order, plaintiff was engaged in the business of selling and constructing tanks in California. In the course of its business those materials might be used in California or elsewhere. It cannot be said therefore that they were not purchased for use here. They were purchased for use in California if and when the business required their use here to fill an order. The requirement arose and they were used in this state. It follows that those particular materials were purchased for use in California. The materials being used here following the intent to use them upon a certain contingency, it objectively follows that they were acquired for use here."

Another question raised in the American Airlines case was whether the imposition of the tax was precluded by the fact that following the installation of the items on aircraft the property was substantially consumed in interstate commerce outside of the state. The court said that this made little difference; that it was not particularly concerned with the ultimate consumption of the property "but rather with whether American contemplated storage and installation in California at the time of purchase of the items and whether there was storage and installation in California."

It appears that the decision of the court is controlling here and that the spare parts stored and installed by “C” at its Los Angeles station must be regarded as being purchased for storage, use or other consumption in this state within the meaning of Section 6201.

Turning to the other issues, it is first asserted that “C” is exempt from the California use tax because it is an instrumentality of the _____ government. Some years ago a similar exemption from property taxation was sought by a scientific laboratory which claimed to be an official agency of the British Commonwealth of Nations. Our Attorney General ruled that "(t)he Constitution and laws of this State do not permit such an exemption and none can be afforded unless compelled by appropriate treaty or by international law.” Opinion of the Attorney General No. 49-245 (1950).

Secondly, it is contended that “C” is exempt from tax by treaty and by the laws of comity. We understand that in the first instance you are referring to the income tax convention between the United States and _____. We assume that by “the laws of comity” you mean “That body of rules

which states observe towards on another from courtesy or mutual convenience, although they do not form a part of international law." Black's Law Dictionary.

As far as the latter is concerned, we submit that the principle of comity does not extend to corporate entities carrying on commercial activities. We call your attention particularly to United States v. Deutsches Kalisyndikat Gesellschaft, et al., 31 F.2d 199. In that case suit was brought by the United States against Deutsches Kalisyndikat Gesellschaff, Societe Commerciale des Potassas d'Alsace, and others, to enjoin violations of anti-trust laws. The French ambassador intervened, contending that the suit brought against the Societe was in fact brought against the French government. The court held that the Societe did not enjoy sovereign immunity, even though it was organized and controlled by the French government, and even though 11/15 of the capital stock was owned by the government. The court stated as follows:

> "The defendant company being an entity distinct from its shareholders, immunity cannot be claimed by it or on its behalf on the ground that it and the government of France are identical in any respect. Private corporations in which a government has an interest, and instrumentalities in which there are private interests, are not departments of government."

The contention that the income tax treaty between the United States and _____ serves to exempt "C" from the California use tax must also be rejected. The treaty contains no provision which grants immunity from state excise taxes imposed on the storage, use or other consumption of tangible personal property. Article I(a) _____ expressly provides that the taxes referred to in the convention are:

> "(a) In the case of the United States: The Federal income taxes (including surtaxes and excess profits taxes) and the documentary taxes on sales or transfers of shares or certificates of stock or bonds."

The fact that the payment of a use tax may have an indirect and remote effect on the earnings of "C" does not, of course, make the use tax equivalent to an income tax.

It is next contended that the imposition of the tax is improper because international air carriers operating in _____ are not subject to a use tax liability in that country. This alone would not constitute a basis for tax exemption. Again, the exemption must be based on treaty or international law. As already indicated, the principle of comity does not appear to apply to corporations even though owned and controlled by foreign governments.

Finally, it is contended that the imposition of the tax is prohibited by the commerce clause and is hence unconstitutional. Once more we believe the decision in the American Airlines case is controlling, there appearing to be no reason for distinguishing between aircraft operating in interstate commerce and aircraft operating in foreign commerce. The court ruled as follows:

> "The fact that American is engaged extensively or exclusively in interstate commerce, that the property in question is dedicated to interstate commerce and is ultimately consumed in interstate commerce, that the property here involved is in California for a comparatively short period of time and that the property was in part

in interstate commerce before its storage, retention and installation in California and was consumed in interstate commerce after its storing, retention and installation in California is of little consequence under the particular circumstances of this case. The arguments and the disposition made in the Southern Pacific Co. and Pacific Telephone (Pacific Tel. & Tel. Co. v. Gallagher, 306 U.S. 182 (59 S.Ct. 396, 83 L.Ed. 59)) cases in the Supreme Court of the United States determine in large part the outcome of this case.

"With reference to the assertion that the tax is a burden on interstate commerce the court in Southern Pac. Co. v. Gallagher, 306 U.S. 167 (59 S .Ct. 389, 83 L.Ed. 586), said at page 177:

"'(W)e think there was a taxable moment when the former had reached the end of their interstate transportation and had not begun to be consumed in interstate operation. At that moment, the tax on storage and use--retention and exercise of a right of ownership, respectively, was effective. The interstate movement was complete. The interstate consumption had not begun,'"

In view of the foregoing points and authorities, we must conclude that "C" is liable for use tax measured by the purchase price of spare parts shipped to its Los Angeles station and installed there. We will recommend, however, that the determination be adjusted to the extent that it includes the purchase price of parts shipped to Los Angeles but transshipped to points outside California for installation.

If you desire a Board hearing on the matter, please advise us within 30 days.

Patricia McKinney
Assistant Counsel

PM:dse [lb]

June 8, 1964

This is in response to your request for an opinion on whether _____ is liable for use tax on the storage, use or other consumption in this state of spare parts, engines, ground equipment, and office supplies used in connection with its operations in foreign commerce.

In brief, _____ is a legal entity organized under the laws of _____. It conducts regularly scheduled flights into and out of California. All such flights are in foreign commerce; there are no flights in intra or interstate commerce. In order to service its flights in foreign commerce, however, _____ maintains a substantial store of spare parts, engines, ground equipment and office supplies in California.

_____ contends that the imposition of the use tax on the storage, use or other consumption of such equipment in California is precluded by the doctrine of federal pre-emption. The airline states that the federal government has entered into treaties prohibiting the imposition of tax on certain kinds of property (specifically including "property consisting of air transport undertakings") held by nationals of the other country, and that under the decision of the California Supreme Court in Scandinavian Airlines System, Inc. v. County of Los Angeles, 56 Cal. 2d 111, the immunity extended thereby pertains to all foreign nationals. It is contended, in substance, that under the court's reasoning the imposition of a use tax is also prohibited.

A review of the relevant points and authorities has led us to the opposite conclusion for the reasons stated below.

1. The treaty between the United States and _____ does not contain any provision which grants immunity from either national or local taxes imposed on the storage, use or other consumption of tangible personal property.

Article I of the _____ expressly provides that the taxes referred to in the convention are:

> "(a) In the case of the United States of America: The Federal income taxes, including surtaxes and excess profits taxes;
>
> "(b) In the case of _____. The income tax, the corporation tax and the _____."

Subsequent provisions contain no reference to taxes on property or to taxes on the use of property.

With one exception there is also no reference in the convention to taxes imposed by the several states of the United States or by the provinces of _____. That the convention was not intended to cover such taxes is indicated in the report of the Secretary of State which accompanied the President's message to the United States Senate seeking ratification of the convention. This report states:

> "As to the United States, the provisions establishing rules for avoidance of double taxation and for administrative cooperation apply only to the Federal income taxes, including surtaxes and excess profit taxes. They do not apply to taxes imposed by

> the several states of the United States, the District of Columbia, or the Territories or possessions of the United States." (Emphasis supplied.)

A statement to the same effect appears in the report of the Senate Foreign Relations Committee _____.

The one exception relates to discriminatory taxes against foreign nationals of one country residing in the other. To quote again from the Secretary of State's report:

> "Article XVIII provides … (c) that citizens of one of the countries shall not, while resident in the other country, be subject therein to other or more burdensome taxes than are the citizens of such other country residing therein. The latter is a standard national treatment provision and is the only provision in the convention which applies to the taxes imposed by States, the District of Columbia, and Territories or possessions of the United States as well as to Federal taxes." (Emphasis supplied.)

In this regard, it is noteworthy that the United States does not impose a tax comparable to the sales or use tax. The _____, on the other hand, imposes two taxes which appear to be quite comparable, namely, the "_____ tax" and the "_____ tax". These taxes are not covered by the tax convention between the two nations; hence, an American corporation with business connections in _____ apparently enjoys no special immunity from them. _____.

2. As far as we know, there is no similar treaty with any other foreign nation which grants immunity from taxes imposed on the storage, use or other consumption of tangible personal property. Accordingly, the objections which prevailed in the Scandinavian Airlines case are not present here.

In Scandinavian Airlines System, Inc. v. County of Los Angeles, 56 Cal. 2d 111, the court found that a property tax levied on aircraft registered and based in Sweden was prohibited by the terms of the tax treaty between that country and the United States. It also ruled that such a tax could not be imposed on SAS aircraft registered and based in Norway and Denmark, even though the treaties with those countries contained no provisions relative to property taxation. The court reasoned that if the local governments were prohibited from taxing Swedish airlines, yet free to tax planes owned and based in other foreign countries, there would result discrimination between foreign commerce based in a treaty country and similar commerce based in other nations. "Such discrimination", the court said, "would constitute interference with the free flow of commerce."

The possibility of discriminatory treatment is not present in this instance, since to our knowledge none of the tax treaties entered into by the United States prohibit or restrict the application of a state tax on the use of tangible personal property within its boundaries.

It is true that treaties with certain countries other than _____; namely, the treaties with Sweden and France, contain express provisions relating to property taxation. However, it is well established that the use tax is not a tax on property, but an excise tax levied on the privilege of use, storage or consumption of property. The argument to the contrary was rejected in Douglas Aircraft Co. v. Johnson, 13 Cal. 2d 545, wherein the California Supreme Court stated:

> "[I]t is obvious from a reading of the act, that the tax here levied is not imposed on the ownership of property as such. It does not apply to the use of property to be resold. It does not recur annually, but falls due only once. It is not imposed on a fixed day, although it is collectible quarterly--in short, it does not fall upon the owner because he is the owner, regardless of the use or disposition he may make of the property. It is imposed on certain of the privileges of ownership, but not upon all of them."

3. The imposition of the use tax on the storage, use or other consumption of spare parts and other equipment in this state by _____ does not constitute an interference with foreign commerce.

In the statement submitted on behalf of _____ it is concluded that the concern underlying the court's objection in the Scandinavian Airlines case to state taxation of foreign commerce applies equally to both property taxes and use taxes. We submit, however, that the court found a potential interference with foreign commerce arising from the fact that foreign-owned airlines based in different countries might be accorded different treatment, depending upon particular treaty provisions. It did not hold that taxes on foreign airlines were per se an unconstitutional interference with foreign commerce.

As stated earlier, the United States has apparently not entered into a treaty with any foreign country which prohibits a state from asserting a use tax liability against a foreign airline storing, using or otherwise consuming tangible personal property within its boundaries. It follows that the imposition of the tax does not create the danger of discriminatory treatment which the court feared in the Scandinavian Airlines case.

In summary, we do not believe there is any constitutional objection to the imposition of the use tax under the present circumstances. However, we would be pleased to consider any further objections you may wish to assert on behalf of your client.

Very truly yours,

Patricia McKinney
Assistant Counsel

PM:ls [lb]