

M e m o r a n d u m**325.1584**

Mr. Gary J. Jugum

Date :

June 6, 1977

From: Mary C. Armstrong

Subject: P--- O---, Inc.

DH AH XX XXXXXX

Pursuant to your request I have researched the question of whether the cigarette tax or the alcoholic beverage tax or the sales tax properly apply to sales out of a bonded warehouse to a foreign naval vessel.

This problem arose in the case of sales of distilled spirits and cigarettes made by P--- O---, Inc. to the HMAS P---, an Australian Naval vessel, stationed, in the Fall of 1974, at the Long Beach Naval Shipyard. The sales were made from P--- O---'s bonded warehouse in September, October and November of that year. After a preliminary hearing in 1975 it was concluded that cigarette and alcoholic beverage excise taxes could properly apply to these sales. The decision of the Hearing Office was based upon his finding of fact that the purchases were made for local consumption (i.e., for use by the HMAS P--- crew while stationed in Long Beach.

Taxpayer – P--- O--- did not report sales tax on the transactions. Indeed, taxpayer does not hold a seller's permit.

Provisions for tax-free withdrawals and transfers of distilled spirits and cigarettes are set out in Chapter 51 and 52 of the Internal Revenue Code (Title 26, U.S.C.A. Sections 5214 and 5704.)

26 U.S.C.A. Section 5214 provides that:

“(a) Purposes. -- Distilled spirits on which the internal revenue tax has not been paid or determined may, subject to such regulations as the Secretary or his delegate shall prescribe, be withdrawn from the bonded premises of any distilled spirits plant in approved containers - -

(1) free of tax after denaturation of such spirits in the manner prescribed by law for- -
(A) exportation;...

(7) without payment of tax for use of certain vessels and aircraft, as authorized by law,...”

26 U.S.C.A. Section 5704 provides:

“-- A manufacturer or export warehouse proprietor may transfer tobacco products and cigarette papers and tubes, without payment of tax, to the bonded premises of another manufacturer or export warehouse proprietor, or remove such articles, without payment of tax, for shipment to a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States, or for consumption beyond the jurisdiction of the internal revenue laws of the United States; and manufacturers may similarly remove such articles for use of the United States; in accordance with such regulations and use such bonds as the Secretary or his delegate shall prescribe.”

In addition, Title 19, U.S.C.A. Section 1309 exempts, from custom duties and internal revenue tax, articles of domestic origin from an internal revenue bonded warehouse which are withdrawn for use by vessels of war of any foreign nation (19 U.S.C.A. Section 1309(a)(2)).

Title 19, U.S.C.A. Section 1202, Revised Tariff Schedule 8, sub-part C, Sections 820.40 and 822.20 exempt from any custom duties articles entered into the United States for the personal or family use of persons who are aliens on duty in the United States including members of the armed forces of any foreign country.

The regulations issued pursuant to 19 U.S.C.A. Section 1202 provide that all custom charges and exactions “to articles entered or withdrawn from warehouse” are inapplicable when the items are for a member of the armed forces of another country. (19 CFR 10.30C (1965)). (Emphasis added.)

Thus, in situations where cigarettes or distilled spirits are withdrawn for use by members of the armed forces of the United States, federal law and regulations prohibit the imposition of any federal customs duties or internal revenue taxes. In the case before us P--- O--- was permitted to withdraw from the bonded warehouse both the cigarettes and the distilled spirits without payment of federal excise taxes or customs duties.

In deciding whether California can require payment of the sales, cigarette or alcoholic beverage taxes in a situation such as the P--- O--- sales, a question arises as to whether or not the federal government has pre-empted any state action in this regard by virtue of Title 19, U.S.C.A. Section 1309 exempting the levy of any federal taxes or customs duties. The answer to this question requires an analysis of each of the applicable statutes separately.

Sales Tax

CTS Annotation 325.0880 (November 12, 1963) interprets Title 19, U.S.C.A. Section 1309 as exempting the sale of alcoholic beverages out of bonded warehouses from both state regulation and taxation. This interpretation is based in part on two decisions:

McGoldrick v. Gulf Oil Corp. (1940) 309 U.S. 414, 84 L.Ed. 840 and
National Distillers Products Corp v. San Francisco (1956) 141 Cal.App.2d 651.

In Gulf Oil, New York City sought to impose a municipal sales tax on fuel oil manufactured in bond in New York City from crude petroleum which had been imported from a foreign country, to New York and withdrawn, sold and delivered to ships' stores to vessels engaged in foreign commerce. The court noted that the exemption and drawback provisions of Section 1309 were designed to relieve the importer of the import tax so that he might meet foreign competition in the sale of fuel as ship's stores. The court state that "it is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress and which might equal or exceed the remitted import duty."

In National Distillers Products Corporation, California sought to assess property taxes against liquor labeled for export. The California court disallowed the tax noting that "the purposes of the Congressional regulation applicable to this phase of foreign commerce (Section 1309) would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred by Congress upon the said spirits or infringe on the Congressional regulation of this class of foreign commerce."

It is thus clear that since federal law has regulated the withdrawal of ship's supplies from bonded warehouses, Congress has pre-empted this field of commerce from state regulation or taxation. The fact that no sales tax was imposed in this situation is thus consistent with our prior interpretations.

Cigarette Tax

Revenue and Taxation Code Section 30102.5 provides that taxes imposed by the Cigarette Tax Law "shall not apply to the distribution of cigarettes that are non-tax-paid under Chapter 52 of the Internal Revenue Act of 1954 as amended, and the cigarettes are under internal revenue bond or customs control.

The exemption provided for under Section 30102.5 for sales of cigarettes from bonded warehouses appears at first glance to be narrowed by the requirements of Cigarette Tax Regulation 4079 which imposes a three-fold set of conditions on such sales.

Cigarette Tax Regulation 4079 provides that:

"The tax does not apply to sales of cigarettes where all three of the following conditions exist:

- (a) The cigarettes sold are exempt from federal tax on cigarettes under the provisions of Chapter 52 of the Internal Revenue Act of 1954; and

- (b) The cigarettes are under the federal bond required to secure their exemption from the federal tax and are to leave the state under federal customs control;
- (c) The cigarettes are sold for shipment to foreign countries or for use as ships' supplies which are to be consumed or resold on the high seas or in foreign countries." (Emphasis added.)

If Regulation 4079 is followed, the sales of cigarettes made by P--- O---, Inc. to the HMAS P--- are clearly taxable because the Hearing Officer in this situation found as a matter of fact that the frequency and amount of the sales made over the three-month period in 1974 clearly suggested that the cigarettes were for consumption within this state and did not "leave the state to be consumed or resold on the high seas or in foreign countries."

At first glance there appears to be a conflict between Cigarette Tax Law 30102.5 and Regulation 4079 in that the later imposes the additional requirement in part (c) that the cigarettes must be sold for shipment or for use on the high seas or in foreign countries. In actuality part (c) merely is a restatement of Federal Internal Revenue Regulation 290.27 which provides that:

"Exportation or export shall mean a severance of cigars, cigarettes, or cigarette papers or tubes from the mass of things belonging to the United States with the intention of uniting them to the mass of things belonging to some foreign country. For the purposes of this part, shipment from the United States to Puerto Rico, the Virgin Islands, or a possession of the United States, shall be deemed exportation, as will the clearance from United States of cigars, cigarettes and cigarette papers and tubes for consumption beyond the jurisdiction of the internal revenue laws of the United States, i.e., beyond the 3-mile limit or international boundary, as the case may be." (31 F.R. 290.27 (1966)). (Emphasis added.)

If the sales made by P--- O--- had been made to a foreign ship at berth in a California port, then under both California and Federal law excise taxes could be imposed because the cigarette sales would have been for consumption with the state rather than on the high seas or beyond the jurisdiction of the internal revenue laws. It is only because the sales were made to members of a foreign armed service that the federal regulation becomes inapplicable by virtue of the blanket exemption given members of foreign armed services in Title 19, U.S.C.A. Section 1309 and Regulation 10.30C. It would thus seem that Section 1309 pre-empts state attempts to tax sales of cigarettes made to members of foreign armed services. Therefore, with regard to the sales made by P--- O--- to the HMAS P---, California could not impose its cigarette excise tax.

Alcoholic Beverages

Section 32211 of the Alcoholic Beverage Tax Law sets up a presumption "that all distilled spirits acquired by any taxpayer have been sold in this State by him unless one of the following is proven to the satisfaction of the board, in reports on forms prescribed by the board:

- (a) That the distilled spirits are still in the possession of the licensee.
- (b) That the distilled spirits have been sold or delivered to another licensed distilled spirits manufacturer, rectifier, importer, or wholesaler.
- (c) That the distilled spirits have been exported without this state or sold for export by the licensee making the report and actually exported from this State within 90 days from the date of the sale.
- (d) That prior to the termination of possession of the distilled spirits have been lost through unintentional destruction.
- (e) That prior to the termination of possession there has been an unaccounted for loss, but the unaccounted for loss shall not exceed a tolerance to be fixed by the board.
- (f) That the distilled spirits are otherwise exempt from taxation under this part."

In the case of P--- O---, it was determined that the sales of alcohol made to the HMAS P--- did not come within any of the state exceptions of Section 32211 because "the distilled spirits were delivered to the purchaser in California and no documentary evidence appears that the goods were in fact exported."

As with the sales and cigarette taxes, a question is again raised whether the provisions of Section 32211 contravene stated federal policy as expressed in Title 26, U.S.C.A. Section 5214 and Title 19, U.S.C.A. Section 1309. In the case of alcoholic beverages, however, a different analysis is required because of a broad constitutional grant provided to the states with regard to the regulation of sales of alcohol as expressed in Section 2 of the Twenty-first Amendment to the United States Constitution. Section 2 provides:

"The transportation or importation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

Section 2 has been interpreted by the Supreme Court to allow a state to impose a license fee for the privilege of importing beer to any place within its borders (State Board of Equalization v. Young's Market Company, (1936) 299 U.S. 59; 81 L.Ed. 38.) Under this section

it is also permissible to impose excise provisions of the Alcoholic Beverage Control Act, laying a tax, at a specified rate per unit sold, on beer, wine, and distilled spirits sold "in this state," notwithstanding the fact that the sales take place within the limits of a national park and the state could not validly require licenses for the importation or sale of alcoholic beverages in the park. (Collins v. Yosemite Park & Curry Co. (1938) 304 U.S. 518, 82 L.Ed. 1502).

Under these decisions it is permissible for California to impose its alcoholic beverage excise taxes on sales such as those made by P--- O---, to the HMAS P--- since the Hearing Officer found as a fact that the alcoholic beverages were purchased for consumption in this state.

A different result would apply if the purchases were clearly made for export since under Section 3221 and Hostetter v. Idlewild Bon Voyage Liquor Corp. (1964) 377 U.S. 324, 12 L.Ed.2d 350, the sale of in bond liquors to departing passengers, where the ultimate delivery and use is not in the state but in a foreign country, is exempt from state control. In such a situation, even the Twenty-first Amendment would not give a state the right to regulate, control or prevent "transactions carried on under the aegis of a law passed by Congress in the exercise of its explicit power under the Constitution to regulate commerce with foreign nations." (Hostetter, *supra*, 12 L.Ed.2nd 350 at 357).

In conclusion, Title 19, U.S.C.A. Section 1309 clearly prevents California from assessing any sales or cigarette taxes on sales from bonded warehouses to foreign naval vessels. In the case of sales of distilled spirits from bonded warehouses, where the spirits are ultimately consumed within this state, the alcoholic beverage tax can be imposed because of the state's great interest in regulating consumption of intoxicating liquors in this state as provided for in Section 2 of the Twenty-first Amendment.

MCA:jw.