

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

600.0115

In the Matter of the Petition)
for Reconsideration of a Final) DECISION AND RECOMMENDATION
Determination Under the)
Sales and Use Tax Law of:)
)
[A], INC.) No. SR --- XX-XXXXXX-010
)
)
Protestant)

The preliminary hearing on this taxpayer's petition was held in Sacramento, California, on August 18, 1986.

Hearing Officer:	James E. Mahler
Appearing for Petitioner	M--- E. G---
Appearing for the Board	Robert J. Wils Supervising Auditor

<u>Protested Item</u>	<u>Measure</u>
The purchase price of a vessel subject to use tax.	\$1,379,220

Contentions of Protestant

1. The purchase is exempt from the tax under the provisions of Revenue and Taxation Code Section 6368.

2. The purchase price includes capitalized labor and other services performed by protestant which are not properly includable in the measure of tax.

Summary of Protest

The protestant is a corporation that is engaged in operating cruise ships on Lake Tahoe. Lake Tahoe is situated in the states of California and Nevada.

The protested item consists of use tax determined on the purchase price of the "T---". The T--- is a large paddle wheel vessel with a carrying capacity of approximately 500 passengers. The staff has based its determination on the conclusion that the vessel operates on a regular schedule primarily in California with only incidental transportation in the Nevada portion of the lake.

The protestant contends that the vessel performs substantial charters and dinner cruises that traverse Nevada waters and that some cruises to Emerald Bay actually involve a return along the East Shore in Nevada waters. It has submitted a logbook and other evidence (Exhibits A through D) detailing each voyage. Collectively it is submitted that on a trip-by-trip basis more than 60 percent of the cruises involve at least some transportation in Nevada. It is submitted that all of the trips involving any transit in Nevada waters constitute interstate commerce. It thus contends that the purchase qualifies for exemption as watercraft use for hire in interstate commerce (Rev. & Tax. Code §6368).

Protestant also contends that the audited purchase price (gross value per books) includes costs incurred by its personnel in the course of assembly which are not properly a part of the measure of tax. It has reserved the right to present evidence on this point at a later date.

The protestant's argument and brief of the applicable law are set forth in writings dated November 6, 1984, and October 8, 1986, copies which have been made a part of the file in this matter.

Analysis and Conclusions

Revenue and Taxation Code Section 6368 provides an exemption from the sales and use tax for a watercraft acquired "for sue in interstate or foreign commerce involving the transportation of property or persons for hire". This provision is implemented by the provisions of Sales and Use Tax Regulation 1594, which provides the following basis and standard for determining if the exemption is applicable.

"(a) General Exemption. Tax does not apply to the sale of nor to the storage, use, or other consumption of watercraft which are used, leased to a lessee for use, or sold to persons for leasing to lessees for use for any of the following purposes:

"(2) To make voyages both in interstate or foreign commerce and voyages that are exclusively in intrastate commerce provided the principle use of the watercraft is transportation for hire in interstate or foreign commerce. The tax applies with respect to watercraft making voyages both in interstate or foreign commerce and voyages that are exclusively in intrastate commerce where the principle use of the watercraft is in intrastate commerce.

“(b) Use of Watercraft

“(1) Interstate and Foreign Commerce. In determining whether a purchaser or a lessee of a watercraft is using that watercraft in interstate or foreign commerce, only that use of the watercraft by the purchaser or lessee during the first 12 consecutive months commencing with the first operational use of the watercraft will be considered. If the purchaser does not own the watercraft for 12 consecutive months commencing with the first operational use, then the period of time commencing with the first operational use that the purchaser owns the watercraft will be considered.

“(4) For purposes of this regulation:

“(A) ‘Principal Use’ means more than one-half of the operations use during the test period.

“(B) ‘Operational Use’ or ‘functional use’ means the actual time during which the watercraft is operated and shall not include storage, modification, repair, or replacement.” (Emphasis added.)

The performance of transportation for others, as an independent business, constitutes “commerce”. (Wabash St. Louis P. R. Railway Co. v. Illinois, 118 U.S. 557.) The question remains, however, as to whether a given trip with an origin and destination in California constitutes “interstate” commerce by reason of traversing a portion of the lake located in Nevada during some portion of the trip. The issue has been resolved by prior decisions of the United States Supreme Court.

In Central Greyhound Lines Inc. v. Mealy, 334 U.S. 653, the court precluded the State of New York from applying a non-apportioned gross receipts tax to transportation of persons between two points in New York over a route partly within the boundaries of another state. In so holding, it disapproved or distinguished prior cases which had approved local taxation on the basis that “the passage through another state was a mere geographic incident in the consummation of a purely local transaction”. (See discussion in dissenting opinion; also see Hanley v. Kansas City Southern Railway Co., 187 U.S. 617 and Missouri Pacific Railway Co., 267 U.S. 404, which reached the same result with respect to attempts to apply state regulatory laws.)

The staff has cited the case of MGRS v. State Board of Equalization (Case No. C96419), which dealt with transportation between Long Beach and Catalina Island, as authority that the activity is not interstate commerce. The present situation is quite distinguishable from transportation between the mainland of California and Catalina Island, which does not touch any other state and thus does not constitute “interstate” commerce.

We have examined the protestant's logbook and the other evidence presented in support of its claim. We find it to be accurate and in support of its claim that more than 60 percent of its trips involved travel in waters located within the State of Nevada. While a substantial portion of the transit was not over regularly scheduled routes, the basis for the chartered exceptions are generally documented.

We conclude that the watercraft is exempt under the quoted provisions of Revenue and Taxation Code Section 6368 but only on this basis. Absent this statute, a constitutional exemption would not be applicable to this particular activity.

Recommendation

It is recommended that the taxes determined on the vessel be cancelled pursuant to the provisions of Revenue and Taxation Code Section 6981.

James E. Mahler, Hearing Officer

4/9/87

Date