STATE OF CALIFORNIA

BOARD OF EQUALIZATION **500.0030**

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
---	)	No. ---
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel David H. Levine on March 10, 1993 in Sacramento, California.

Appearing for Petitioner:	A Manager, Commodity Taxes
Appearing for the Sales and Use Tax Department:	Jack Warner District Principal Auditor

Protested Item

The protested tax liability for the period April 1, 1987 though March 31, 1990 is measured by:

	Item	State, Local and County	EQRF	Transit Districts
B.	Complimentary use of liquor based on California passenger miles	$190,047	$21,817	$206,675

Petitioner's Contentions

The Board cannot impose tax on petitioner's complimentary use of liquor based on the Board's own regulations and based on federal law and treaties.

Summary

Petitioner is an air common carrier based in Canada. The only California airports it flies into and out of are XX International Airport and XY International Airport. All such flights departing the California airports fly directly to either Calgary or Toronto. All such flights arriving at the California airports fly directly from Calgary or Toronto.

During these flights, petitioner served its passengers complimentary alcoholic beverages. No California sales or use tax had been paid with respect to these beverages. Petitioner states that all alcoholic beverages served on its flight are bonded liquor purchased in Canada. It further notes that under Customs regulations, its in-flight bars must be locked and sealed prior to landing and must remain locked and sealed during the entire ground stop.

The Sales and Use Tax Department (Department) issued a Notice of Determination to petitioner for use tax on its use of extax alcoholic beverages while in California air space. The Department calculated the measure of tax using the passenger miles method, as provided by Regulation 1620.2. The measure of that tax was calculated to be $190,047. In its petition, petitioner stated that the measure in question is $235,718. A review of the records during the conference indicated that the purchase price of the property in question was, indeed, $235,718, but that amount was in Canadian dollars. The Department had adjusted this figure, based on the rate of exchange, prior to issuing the Notice of Determination. Thus, the parties are in agreement with respect to the amount in dispute.

Analysis and Conclusion

The first issue to be resolved is whether federal law and treaties permit the state to impose the tax in question and whether the Board's own regulations authorize such taxation. One of the authorities relied on by petitioner is the Chicago Convention on International Civil Aviation of 1944 (ICAO). The specific provision relied on by petitioner is Article 24(a), which is quoted in the petition as follows: "items on board an aircraft of contracting state [meaning in this context a country] and retained on board on leaving the territory of that state shall be exempt from customs duty, inspection fees or similar national or local duties and charges."

The Department asserts tax with respect to the use of property that is on board the aircraft when it first enters California airspace but which is no longer on board when the aircraft departs California airspace. Some of this property is used on the flight into California. The remainder of the property in question is brought into California on the incoming flight without being used thereon. It remains on board the aircraft during its presence on the ground in California and is then used on the flight out of California. That is, all the property in question originated in

Canada but is used in California, either on a flight inbound or on a flight outbound. Article 24(a) of the ICAO applies only with respect to property which is on board the aircraft when it enters the country, and which property remains on board the aircraft when it departs the country. Since the property in question here does not remain on board the aircraft when it departs the United States, the ICAO, by its own terms, does not apply.

Petitioner also asserts that the customs laws and regulations of the United States prohibit the imposition of the tax in question, specifically title 19 U.S.C. section 1309. The Department previously issued a determination assessing tax on alcoholic beverages consumed in California and petitioner filed a petition for redetermination. The Board concluded in 1980 that the provisions of section 1309 did not require an exemption for alcohol removed from bond and consumed in California. As relevant here, there has been no change in section 1309 since 1980 nor has there been any other authority which mandates a different result.

Petitioner does cite Xerox Corporation v. County of Harris (1982) 459 U.S. 145. That case involved the imposition of an ad valorem tax on copiers imported from outside the United States and then stored in a customs bonded warehouse (see 19 U.S.C. § 1555 et seq.). After the period of storage, the copiers were to be exported. As explained by the Court, the purpose of the relevant law was to stimulate foreign commerce by allowing goods in transit in foreign commerce to remain in secure storage, duty free, until they resume their journey in export. (459 U.S. at 150.) That case simply is not relevant here since the tax in question here is not an ad valorem tax imposed merely by virtue of the property's presence in California. Nor was the property in question held in storage in a customs bonded warehouse in California for purposes of export without intervening use. Instead, the property here was in California specifically for the purpose of petitioner's use of that property during its flight, including use of that property in California. It is that *use* in California upon which the Department seeks to impose tax, not merely the property's presence.

In R.J. Reynolds Tobacco Co. v. Durham County (1986) 479 U.S. 130, the Court analyzed a situation similar to that involved in Xerox. In both cases, the taxing state sought to impose a nondiscriminatory ad valorem property tax on property imported from outside the United States and then stored in the taxing state in a customs bonded warehouse. In Xerox, the property was destined for export after the storage and the Court held that the state's tax was preempted. In R. J. Reynolds, after the period of storage in the customs bonded warehouse, the imported tobacco was to be blended with domestic tobacco at a manufacturing plant in the taxing state. The Court upheld the tax, noting that the tobacco had nothing transitory about it: it had reached its state of destination. Here, the alcohol had reached its state of destination. That is, it was brought into California specifically so that petitioner could use it, if necessary, in California.

Petitioner also contends in its petition that the transactions in question are governed by subdivision (b)(2)(B) of Regulation 1620 rather than by Regulation 1620.2. That subdivision states:

> "Use tax does not apply to property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California."

The provision is an application of the Commerce and Import-Export Clauses of the United States Constitution. The latter clause was the provision considered by the Court in R. J. Reynolds. Thus, for the same reasons discussed above, the Import-Export Clause does not preempt the tax assessed by the Department, nor does the regulatory restatement quoted above. Regulation 1620 prohibits the imposition of use tax with respect to the use of property in California only when that property had been first used outside California, had entered California during the course of interstate and foreign commerce, and thereafter had been used continuously in interstate or foreign commerce both inside and outside California. The property in question here was not first used outside California. It was first used inside California and its use therefore fails the first requirement for exemption. Nor is the property thereafter used inside and outside California. Instead, it is fully used inside California when petitioner transfers possession of it to its passengers.

Petitioner also asserts that subdivision (b)(4) of Regulation 1620 governs the transactions. That provision states:

> "Use tax applies with respect to purchases of property imported into this state from another country when the use occurs after the process of importation has ceased and when sales tax is not applicable, regardless of whether the property is in its original package."

Petitioner asserts that the property was always in the process of importation and that it therefore is regarded under federal law as not being in California. Initially, I note that although property actually in the process of importation may be immune from state taxation, federal law does not create a fiction that the property is not physically in the state. Rather, as explained in R. J. Reynolds and Xerox Corporation, the immunity was created to protect federal revenues and to avoid a multitude of "voices" speaking with respect to foreign commerce. Once the process of importation ceases, the immunity from state taxation ceases.

The "process of importation" clearly does not extend into the period where the property is actually put to its intended use. To reach such a result would require that the concept of importation be stood on its head. The process of importation is the process of transporting property across national boundaries to a point where the property is *thereafter* sold or put to its intended use. This is explained in Sugarman v. State Board of Equalization (1958) 51 Cal.2d 361. In that case, the plaintiff imported a yacht into California. The yacht was uncrated after the ship carrying it docked in San Francisco, and the yacht was thereafter used in California. Plaintiff argued that his use of the yacht in California was not subject to tax, apparently because when the yacht first entered the territory of California, it was in the process of importation. The court explained that it was not required to select as a taxable event a point in time when the goods are constitutionally exempt (when the vessel importing the yacht crossed into California) and to declare that because the goods were immune at that time they could not be taxed at a later time. (Id. at 369-70.) When the beverages in question here crossed into California, they may very well have been in the process of importation. However, they were removed from the process of importation once they were removed from their storage locations and used for their intended purpose. The state can validly impose use tax on that use.

Petitioner's final argument is that, although Regulation 1620.2 governs beverages sold or served by carriers, its definition of "carrier" does not include "foreign carrier" as defined in Regulation 1621. Based on this, petitioner believes that it should be governed by subdivision (b)(2)(B) of Regulation 1620. That provision does not apply to the transactions in question for the reasons discussed above. Regulation 1621 defines "common carrier" as well as defining "foreign air carrier." Petitioner comes within *both* definitions. Nevertheless, the definitions of Regulation 1621 are irrelevant to the application of Regulation 1620.2. The definitions in Regulation 1621 are required by virtue of the specific exemptions which that regulation interprets and applies. (See Rev. & Tax. Code § 6385.) Regulation 1620.2 does not interpret or apply any exemptions which include specific definitions. Rather, that regulation interprets and applies the general sales and use tax laws to a specific aspect of a specific type of business, carriers. The regulation makes no distinction between foreign carriers and domestic carriers, but rather applies to all carriers. Petitioner is clearly a carrier as defined in Regulation 1620.2. That regulation therefore governs the transactions in question, and it provides that petitioner's use of alcoholic beverages in California is subject to use tax.

For the reasons stated above, I conclude that petitioner's use of alcoholic beverages in California is subject to use tax. Subdivision (d)(2) of Regulation 1620.2 provides that a carrier may report its tax liability from the use of taxable beverages in California by allocating to California use a portion of its total cost of taxable beverages served on a complimentary basis based on the ratio that its passenger miles in California bears to its total system-wide passenger miles.

Subdivision (d)(1) provides that a carrier may use another method if that method accurately reports the tax due on the carrier's use of taxable beverages in California. If the carrier wishes to use a method other than the passenger miles method, it must be prepared to demonstrate by records which can be verified by audit that its method accurately reflects the taxable measure. In lieu of any other proposed allocation method by petitioner, the Department calculated petitioner's tax liability using the passenger miles method, and that forms the basis of the Notice of Determination.

During the conference, petitioner asserted that the passenger miles method overstated its taxable use of alcohol in California. The Department agreed to review any method petitioner proposed, along with supporting documentation, by which petitioner would try to establish a more accurate method than the default method provided by the regulation. This is appropriate and authorized by subdivision (d)(1) of Regulation 1620.2, which provides that a carrier may use any reporting method which accurately reports the tax due on taxable beverages sold or used in this state. As of this time, petitioner has not provided the documentation necessary to establish that there is a more accurate method, and there is therefore no basis for adjustment.

The Department notes that an audit is scheduled for the period after the one under consideration here, and that during that audit, petitioner may present documentation to support a different method of calculating its tax liability. If so, there may be grounds for a claim for refund with respect to the liability considered here. Any such claim must be filed within the limitations period set forth by statute. (See Rev. & Tax. Code § 6902.)

Recommendation

Redetermine without adjustment.

July 19, 1993

David H. Levine — Date
Senior Staff Counsel