STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
PENRYN LUMBER COMPANY	)	Account Number SR KH 100-529270 Case ID 554162
Petitioner	)	Orangevale, Sacramento County

Type of Business: Wholesaler and retailer of lumber

Audit period: 10/01/06 – 09/30/09

Item	Disputed Amount
Disallowed claimed sales for resale	$640,290

Tax determined and protested	$45,528.82[1]
Interest through 10/31/14	20,635.29
Total tax and interest	$66,164.11
Payments	- 0.51
Balance Due	$66,163.60
Monthly interest beginning 11/01/14	$227.64

The Board heard this matter on September 23, 2014, and deferred action until the October Board meeting.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the measure of disallowed claimed nontaxable sales for resale. We conclude that no adjustments are warranted.

For the audit period, petitioner reported total sales of $2,760,100 and claimed deductions totaling $2,058,158, including $1,899,397 for nontaxable sales for resale, resulting in reported taxable sales of $701,942. Included in its claimed sales for resale were sales of dunnage and other similar materials (lumber and plywood) to Norton Lilly International and Transmarine Navigation Corporation. The Sales and Use Tax Department (Department) concluded that these purchasers

[1] The amount of tax determined is net of a concurred credit of $4,876.22 related to unclaimed deductions for tax-paid purchases resold. Since petitioner filed a claim for refund of the overpayment during the audit, a refund will be made if petitioner prevails in this matter.

operated as packers, loaders, and shippers, and that they purchased the lumber and plywood to secure cargo being shipped out of the country by their international clients. Specifically, the lumber and plywood were used to create a stable floor within vessels upon which rice was placed for shipment, protecting the rice from coming into contact with the metal of the ship during transport. The Department concluded that the lumber and plywood were used to condition, preserve, and protect the rice during shipment, and thus that the sales of the lumber and plywood were taxable under California Code of Regulations, title 18, section (Regulation) 1630, subdivision (b)(1)(A), resulting in the disallowance of 40 claimed nontaxable sales totaling $640,290.

Petitioner contends that the floor created by use of the lumber and plywood qualifies as a container. Although subdivision (b)(1)(A) of Regulation 1630 provides that "Tax applies to sales to shippers of property used in conditioning the goods to be shipped, or to preserve and protect the goods during transportation," petitioner asserts that this is the exact kind of purpose that a container serves. Petitioner asserts that the subject lumber and plywood should be regarded as having been used as containers for the rice, and that petitioner's sale of that lumber and plywood was thus exempt from tax.

Revenue and Taxation Code section 6364 provides an exemption for nonreturnable containers when they are sold or leased without the contents to persons who place food products for human consumption in the containers for shipment. Regulation 1589, subdivision (a) defines containers as "articles in or on which tangible personal property is placed for shipment and delivery." However, Regulation 1630, subdivision (b)(1)(A) states that tax applies to sales to packers, loaders, and shippers of "property used in conditioning the goods to be shipped, or to preserve and protect the goods during transportation." The regulation specifically distinguishes between property used to condition the goods for shipment or preserve and protect the goods during shipment (Cal. Code Regs., tit. 18, § 1630, subd. (a)(1)) and property used as containers (Cal. Code Regs., tit. 18, § 1630, subd. (a)(2)). As relevant here, bracing materials and dunnage or "loose" lumber are regarded as property used to condition the goods for shipment or preserve and protect the goods during shipment, except when used in the same manner as pallets.

We conclude that the purchasers did not use the lumber and plywood as pallets, for example, to move the rice into the ship and to move the rice out of the ship on such pallets. We conclude that the

lumber and plywood were used specifically to prevent the rice from coming into contact with the metal of the ship, and to prevent the rice from shifting during shipment, that is, as a brace, thereby preserving and protecting the rice during shipment, coming squarely within Regulation 1630, subdivision (b)(1)(A). Accordingly, we conclude that there is no basis for adjustment.

Issue 2: Whether petitioner's sales to shippers in a Foreign Trade Zone are exempt from tax. We conclude that they are not.

During the September 23, 2014 hearing in this matter, petitioner raised an alternate argument, contending that petitioner delivered the property at issue herein to its customers at the Port of West Sacramento, which is a Foreign Trade Zone (FTZ). Petitioner argues that sales occurring in FTZ's are sales in foreign commerce and therefore "federally exempt" from California sales and use taxes. Petitioner has not cited any applicable authority in support of its assertion.[2]

First, we note that the Foreign Trade Zones Act (Act) in relevant part provides that merchandise (i.e., tangible personal property) may be sold, stored, or used in an FTZ without being subject to the *customs laws of the United States*. (19 U.S.C. § 81c; see also *Nissan Motor Mfg. Corp v United States* (1989) 884 F.2d 1375, 1375.)[3] In other words, the Act is a federal statute that provides an exemption from *federal customs duties and tariffs* that would otherwise apply to merchandise upon entry into the United States. (*BMW Mfg. Corp. v. United States* (2001) 241 F.3d 1357, 1363.) There is absolutely no provision in the Act regarding any applicable state or local taxes, or any exemptions therefrom, and it provides no support for petitioner's assertion.[4] We also note that the Act is wholly

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[2] Petitioner cites to several U.S. Supreme Court and California court cases that address goods that are shipped in foreign commerce, *without* intervening use and are already irrevocably committed to the export process at the time of sale. Those authorities are inapposite to the appeal here, in that the timing of the irrevocable commitment to the export process is the dispositive question for this issue.

[3] In relevant part, the Foreign Trade Zones Act provides: "Foreign and domestic merchandise of every description, except such as is prohibited by law, may, *without being subject to the customs laws of the United States*, except as otherwise provided in this chapter, be brought into a zone and may be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured except as otherwise provided in this chapter, and be exported, destroyed, or sent into customs territory of the United States therefrom, in the original package or otherwise; but when foreign merchandise is so sent from a zone into customs territory of the United States it shall be subject to the laws and regulations of the United States affecting imported merchandise. . . ." (19 U.S.C. § 81c (emphasis added).)

[4] The website for the FTZ in question (i.e., the Port of Sacramento) states that "[m]erchandise exported from, or imported into an FTZ is excluded from customs duties and excise taxes until the product leaves the FTZ for U.S. consumption" (http://www.cityofwestsacramento.org/business/foreign_trade_zone.asp, accessed 9/25/14). The context of the statement clearly refers to the excise taxes applicable to property entering the United States for consumption, which necessarily

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inapplicable and inapposite to goods delivered, sold, or transported *from* this country into an FTZ, because such property is not subject to federal customs duties or tariffs when exported from this country. In other words, it is simply immaterial to the application of California sales or use tax laws.

Next, while petitioner has not directly raised the argument, from abundant caution we note that under federal law (specifically, the Buck Act), no person is relieved from liability for the payment or collection of any sales or use tax levied by any state with the jurisdiction to levy such a tax on the ground that the sale or use of the property occurred in whole or in part within a federal area. (4 U.S.C. § 105(a).) States have full jurisdiction and power to levy and collect any such tax in any federal area within the state to the same extent and with the same effect as though the area was not a federal area. (*Ibid*.) Tax applies to the sale or use of tangible personal property upon federal areas to the same extent that it applies with respect to the sale or use of property elsewhere within California. (Cal. Code Regs., tit. 18, § 1616, subd. (a).) Accordingly, there is no applicable exemption or exclusion from the tax based on an FTZ's possible status as a federal area.[5]

Therefore, if the sales in question are to be allowed as exempt foreign commerce sales, petitioner must establish that the sales meet the criteria for the foreign commerce exemption under California law (see Rev. & Tax. Code, § 6396; Cal. Code Regs., tit. 18, § 1620, subd. (a)(3)(C)). The exemption does not apply if the property is delivered to the purchaser prior to an irrevocable commitment of the property into the process of exportation. (Cal. Code Regs., tit. 18, § 1620, subd. (a)(3)(C)(1).) Movement of the property into the process of exportation does not begin until the property has been shipped, or entered with a common carrier for transportation to another country, or has been started upon a continuous route or journey which constitutes the final and certain movement

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means federal customs duties and tariffs. The website does not refer to state excise taxes, and even if it did, the website is not valid authority for an exemption or exclusion from California Sales or Use Tax.

[5] Additionally, we note that an FTZ is not foreign territory. Revenue and Taxation Code section 6017 provides that "in this State" or "in the State" means within the exterior limits of the State of California and includes all territory within these limits owned by or ceded to the United States of America. The Port of Sacramento is within the limits of California and therefore it is "in this state." To the extent that an FTZ is "separate" territory, it is *only* for purposes of customs duties and tariffs: "Reduced to its simplest terms, a foreign trade zone is a properly protected … area which is outside the Customs boundaries of the United States. Thus, *from a Customs angle*, a foreign trade zone is not a part of the United States." (*Hawaiian Independent Refinery v. United States* (1978) 81 Cust. Ct 117, 123-124, quoting testimony from the hearing on a

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of the property to its foreign destination. Consistent with the foregoing, Regulation 1630, subdivision (b)(1)(A) expressly provides that tax applies to sales to shippers of property used in conditioning the goods to be shipped, or to preserve and protect the goods during transportation, and that it is immaterial whether or not the goods are shipped in interstate or foreign commerce.

Here, the property at issue had not begun the process of exportation at the time of sale, because after the sale petitioner's customers *used* the lumber and plywood to secure *other* cargo, *prior* to shipment. The lumber and plywood were not irrevocably committed to the process of exportation because the customers made a functional use of the property, rather than merely transporting it as cargo. Regulation 1630, subdivision (b)(1)(A) clearly provides that such sales are taxable. The sale and use in this state occurred prior to the commencement of the foreign commerce shipment, and therefore the sales do not qualify as exempt sales in foreign commerce.

OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

1948 amendment to the Foreign Trade Zones Act (*Hearing on H.R. 6159 and 6160 Committee on Ways and Means*, 80th Cong., 2d Sess. at 5 (1948)(emphasis added).)

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