

860.0021 **Exemption.** Exemption requires that an appropriately sized vessel be ~~constructed to transport freight or passengers and be used exclusively for such purposes rather than to transport the owner's employees or property, or to transport property as part of a nontransportation project~~ the carrying of freight (property transported by a carrier from a consignor to a consignee) or passengers (travelers by some established conveyance) for hire (*Dragich v. Los Angeles County* (1939) 30 Cal.App.2d 397. Idleness caused by a lack of business or the need for repairs does not interfere with a vessel's otherwise exempt status When the vessel is used by a subsidiary corporation to transport for hire the property of a parent corporation, the relationship between the subsidiary corporation and the parent must be examined to determine whether the subsidiary corporation is an independent corporation or whether the subsidiary corporation is a mere instrumentality, conduit, or agent for the parent corporation. If the corporate entity of the subsidiary corporation can be disregarded, the parent and subsidiary can be treated as one unit, thus defeating any claim that the vessels are transporting freight for hire. C 4/16/87 10/22/86; C 4/21/92. (Am. M99-1, 2000-2).



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October 22, 1986

RE: Exemption Provided for Vessels Engaged in Transportation

Dear:

This is in response to your letter of July 7, 1986, to Mr. Richard H. Ochsner wherein you request our opinion regarding the applicability of the exemption from taxation provided by Section 3(1) of Article XIII of the California Constitution to vessels used by a subsidiary corporation to transport for hire the property of a parent corporation. The facts provided in your letter and the accompanying memoranda from the Office of the County Counsel can be summarized as follows:

The S.S. Coast Range and the S.S. Sierra Madre were both built in San Diego by National Steel and Ship Building Company and delivered to Union Oil Company of California ("Union") on October 29, 1981, and December 18, 1981, respectively. Both vessels were bareboat chartered by Union to West Coast Shipping Company ("West Coast"), a wholly-owned subsidiary of Union, for \$550,000 per month. (Bareboat Charter Parties, p. 7.)

West Coast with its staff of 28 employees operates both state-of-the-art vessels as product carriers under transportation contracts with Union, delivering together more than nine million barrels per year of Union's products to west coast markets. It also operates two other ships regarding which we have no information.

Two virtually identical transportation contracts between West Coast and Union dated September 29, 1981, (for the S.S. Coast Range) and December 15, 1981, (for the S.S. Sierra Madre) require West Coast, the carrier, to provide to Union, the shipper, the two tank vessels for the carriage of cargo designated by the shipper. The shipper

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has the right to name the vessels, display its insignia on the vessels' stacks, fly its house flag and determine the color of paint and the general scheme thereof on the vessels. (Transportation Contracts, p. 1).

The amount of freight agreed to by contract was the sum of all costs to the carrier, including all paid under the charter, plus a management fee. The shipper agreed to indemnify the carrier against all liabilities in excess of the carrier's insurance coverage, except for fraud, willful misconduct or criminal acts. (Transportation Contracts, p. 8)

The complex job of planning and coordinating the West Coast shipping operations is handled at the West Coast office, located in Union's 911 Wilshire building. "Unocal [Union] has an individual who keeps tracking of inventories at marketing terminals and production at the refineries... He lets (West Coast) know what's needed at each location, as well as what each wants to move—when, where and in what amounts. We then take those requirements and try to fit them into a schedule that will satisfy the marketing people, and the limitations of the vessels" (Seventy Six, Jan.-Feb. 1986, p. 11).

Union has stated "[t]he reasons for utilizing a separate Union subsidiary to operate the vessels, rather than having Union operate the vessels directly, are the same as those which are involved in the utilization of an unrelated transportation company: the limitation of liability and the avoidance of complex labor problems which would be associated with direct operation (Letter, May 15, 1986, from Michael A. Lovett, Unocal).

The "Arco California," an oil tanker, is owned by Arco Marine, Inc., a wholly-owned subsidiary of Atlantic Richfield Company. It was purchased from National Steel and Shipbuilding Company on July 15, 1980.

The information available to us indicates the Arco California transported crude oil for hire for the period from March 1, 1981, through March 1, 1985, for several different oil companies, including 1) ARCO Petroleum Products Company, 2) British Petroleum, 3) Champlin, 4) Crysen, 5) Shell, 6) Sonio, and 7) Unocal. No information has been provided about the relative amount of time per shipper.

County Counsel, in a memorandum dated June 3, 1986, has stated that the information provided by Union is persuasive regarding the issue of whether the exemption provided by Section 3(1) of Article XIII applies to the S.S. Coast Range and the S.S. Sierra Madre, but that a court may examine the facts in a property tax context and decide to disregard the separate corporate entity of the subsidiary. Such disregard of the separate nature of parent and subsidiary would defeat the claim for exemption. However, additional information on the ARCO California was requested by County Counsel in a memorandum dated July 26, 1985, before making any determination about the applicability of the exemption to the Arco California.

Analysis

Section 3(1) of Article XIII of the California Constitution exempts from property taxation:

Vessels of more than 50 tons burden in this State and engaged in the transportation of freight or passengers.

The phrase "engaged in the transportation of freight or passengers" has been construed by the California courts to mean the carrying of freight (property transported by a carrier from a consignor to a consignee) or passengers (travelers by some established conveyance) for hire (Dragich v. Los Angeles (1939) 30 Cal.App.2d 397). Thus, the question presented is whether these subsidiary corporations are independent corporations that ship the products of Union and the other petroleum companies for hire, or whether the subsidiary corporations are mere instrumentalities, conduits or agents for the parent corporations. If the corporate entity of the subsidiary corporation can be disregarded, the parent and subsidiary can be treated as one unit, thus defeating any claim that the vessels are transporting freight for hire.

The "alter ego" doctrine, the disregard of the corporate entity because the corporation is the alter ego of others, is applicable not only where the corporation is the alter ego of individuals forming or owning it, but also where a corporation is so organized and controlled, and its affairs so conducted, as to make it merely an instrument, agent, conduit or adjunct of another corporation (McLoughlin v. L. Bloom Sons Co., Inc. (1962) 206 Cal.App.2d 848). "With increasing frequency, courts have demonstrated a readiness to disregard the corporate entity when a wholly-owned subsidiary is merely a conduit for, or is

financially dependent on, a parent corporation" (1B Ballentine & Sterling, Calif. Corp. Laws, 296.01, p. 14-33). Although the doctrine has been applied largely in tort and contract cases to assure a just and equitable result (Thomson v. L.C. Roney & Co. (1952) 112 Cal.App.2d 420; 1A Ballentine & Stirling, Calif. Corp. Laws, 295, p. 24-31), the doctrine has been found applicable to state tax matters to prevent the circumvention of revenue and tax laws (People v. Clauson (1964) 231 Cal.App.2d 374). Factors which the courts have evaluated to determine if the separate existence of the subsidiary corporation should be disregarded are:

1. Presence in both corporations of the same officers or directors.
2. Joint accounting and payroll systems.
3. Subsidiary's lack of substantial business contacts with any save the parent.
4. Subsidiary operates solely with assets conveyed by parent.
5. Subsidiary is shown as a division on parent's financial statements.
6. Subsidiary's property is used by the parent as its own.
7. Subsidiary acts in interest of the parent.

(Annot. (1963) 7 A.L.R.3d 1343, 1355)

Based on the facts presented here, it is difficult to sustain the conclusion that the separate existence of West Coast and Union can be disregarded. Union formed a separate subsidiary corporation to operate the vessels for legitimate business purposes: to limit liability and to avoid complex labor problems which would be associated with direct operation. Union treated West Coast as a separate entity, as shown in the Bareboat Charter Parties in which West Coast leased the two vessels from Union and in the Transportation Contracts in which West Coast agreed to ship Union's products for a specified sum. Moreover, West Coast has two additional vessels about which we have no information, which may be utilized in ways that further support Union's claim that West Coast is an entity separate from Union. Therefore, unless substantial additional evidence is provided to show that West Coast is a mere instrumentality of Union, such as the listing of West Coast as a division of Union rather than

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a subsidiary corporation on Union's financial statements, or the parent used the assets of the subsidiary as its own without regard to corporate formalities, we believe there is insufficient evidence to treat West Coast as the alter ego of Union. Consequently, the exemption provided by Section 3(1) of Article XIII is applicable to the vessels S.S. Coast Range and S.S. Sierra Madre.

Moreover, the evidence you have presented regarding the subsidiary status of Arco Marine, Inc. also does not provide sufficient support for disregard of its corporate entity. The Arco Marine, Inc.'s vessel, the ARCO California, transports the products of the several oil companies named above, including its parent Atlantic Richfield, and appears to be engaged in the transport of freight for hire. Based on this little evidence, we cannot state that the exemption is inapplicable to the ARCO California.

I trust that the above information has been of service to you. If you have any further questions, please do not hesitate to contract me.

Very truly yours,

Barbara G. Elbrecht
Tax Counsel

BGE/rz

cc: Mr. Gordon P. Adelman
Mr. Robert Gustafson
Mr. Verne Walton

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