

TAX MATTERS

A newsletter dedicated to informing California Aircraft and Vessel owners about taxes

Prepared and distributed by Aero & Marine Tax Professionals

Advice About Taxes on Vessels Can Save Thousands of Dollars

"All you have to do is register the vessel outside of California and no tax is due." One dealer told me.

"If you register it anywhere outside of California the tax is avoided. That's the long and the short of it." Another said.

One advised me to, "Dock the vessel in Ensenada for 90 days (note 1) and the tax is avoided completely."

Another added. "All you need is a resale number to not be charged tax."

It's not a question of whether these people are lying or just trying to be a salesperson. They believe what they are saying and in the absence of an audit their advice will never be discovered to be wrong. It is a question of whether a strategy to legally avoid or diminish taxes really exists. This means a strategy that will survive an audit.

Partial truths like the preceding comments have sent many taxpayers screaming. Every lawyer doesn't know every law. Every accountant can't possibly know every regulation of every jurisdiction. What happens generally is that one taxpayer tries a strategy and it seems to work, he tells his friends and the rumor acquires the facade of fact. The basis for the kind of advice I received was probably born from the above scenario.

The following examples are intended to illustrate the kind of "well intentioned" mistake that results in taxes being owed on vessel purchases:

A. A buyer is a resident of Oregon as well as California. The buyer purchases a vessel in and establishes he is a resident of another state. Under all circumstances the State of California can declare the buyer is a resident of California and demand the tax be paid.

In *Garrett Corporation v. State Board of Equalization (Board)* the court said the word "person" in section 6366 indicates a legislative intent that individuals and corporations, whether foreign or domestic, be subject to the same rule with respect to the exemption involved, so the word "resident" in the statute was not limited to a domiciliary concept but contemplated any factual place of abode or some permanency more than a mere temporary sojourn.

B. A buyer owns a business and purchases a vessel from Seller (a dealer or private party.) The buyer provides a valid resale permit number to the seller declaring that the vessel is for resale. Even if the Board determined that the seller made a "good faith" effort to verify the buyer's representation and the seller was not liable to collect the tax, it doesn't preclude the Board from assessing use tax on the buyer if very specific conditions are not met. In the opinion of the Board, if the buyer converts the vessel to any use other than being held for resale, it can't be considered to be "being held for resale." The conditions of their ability to assess use tax on the vessel purchase are very specifically written out.

C. Another example would be where the buyer actually takes delivery of the vessel outside of California. Following the advice of "parking it" for 90 days (note 1) he pays dock fees and leaves it out of state. Subsequent to the 90 days (note 1) the buyer sails the vessel into California and begins using it. The Board will find this transaction to be taxable.

The previous examples are just a few cases where the taxpayers followed their available advice. They were all assessed tax. The public records are filled with many instances of vessel purchases that have resulted in a tax liability. The sad part is that in many cases a proper strategy would have resulted in a non-taxable event. Considering the price of watercraft, this can save the buyer hundreds of thousands of dollars. What is more important, a dealer that can provide the proper tax strategy to his customers as part of his "value-added service" has a significant price advantage. The one who "knows it all" can put himself and the purchaser in jeopardy.

There are a few experts who know the law as it relates to purchases of vehicles, vessels and aircraft. If you follow the steps exactly as they lay them out, you have a chance of saving all or some part of the tax. If you think you know the law, or if you try to use someone else's strategy that worked for their case you could be in for a shock. Each transaction lives or dies on its own merits. Only careful analysis can save you.

The mistake that is very common to all taxpayers is not knowing the depth to which a tax agency can create "loop-holes" for them to collect taxes. Most tax collection agencies view their mission as "collect revenue from every imaginable source." Some agencies promote personnel based on collection statistics. The Senate hearings into IRS tactics has made this clear.

Armed with this basic knowledge, the aforementioned examples illustrate the depths to which the Board of Equalization of the State of California will go to collect money. The good news is that in order to justify their collections all agencies must create a very rigid set of policies, manuals and reliance on previous decisions. Their "methods of attack" create the best possible defense. In their desire to define exactly the guidelines that must be met, they inadvertently give the taxpayer the method to develop a defensible tax strategy.

The Supreme Court declared that it is the duty of all taxpayers to aggressively pursue methods of avoiding taxes. However, misapplying rules isn't a defense. The Justices merely supported your right to avoid taxes. It is illegal to evade taxes. They let you know that if you bother understanding the rules you can "avoid" taxes. "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *SUPREME COURT OF THE UNITED STATES, GREGORY v. HELVERING 293 U.S. 465;*

"Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands."

Federal Appellate Judge Learned Hand

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Thomas A. Alston

(note 1)

The test period was extended from 90 days to 12 months during the period of October 1, 2004 to June 30, 2007.