

VESSEL OWNERSHIP/PURCHASE

BY

A LIMITED LIABILITY COMPANY OR CORPORATION (2016)

The purchase of a commercial ship or recreational yacht may be properly structured by using a corporation or limited liability company (LLC). We recommend corporate ownership.

A corporation or LLC may provide a number of benefits which include protection of the shareholders or members from liability arising out of the use or ownership of the vessel. This is the most important reason to use this structure for the ownership of the vessel.

A corporation or LLC may be setup in any favorable jurisdiction as a holding company. California, Delaware and Oregon are most commonly used.

The following applies primarily to the State of California:

The transfer of the vessel into the LLC or corporation may not be subject to the California Sales and Use Tax. To be exempt the vessel must be free of and clear of all debt at the time of the transfer into the corporation or LLC. If there is an outstanding mortgage on the vessel, the transfer may be subject to the sales or use tax. The transfer must not change the equitable ownership of the vessel. The corporation or LLC must be wholly owned by the original owner or the vessel. We recommend that the vessel be purchased in the name of the LLC or corporation at the time of the original purchase. The original purchase of a new vessel will be subject to the Sales Tax regardless of whether the purchaser is an individual or corporation, if it is purchased in a taxing jurisdiction.

Once the vessel is owned by the corporation or LLC and meets the business purpose requirement, then there may be an opportunity to transfer the ownership of the LLC or corporation to a third party without incurring the sales or use tax depending on the jurisdiction.

WARNING OF RISK

The determination of whether the transfer of stock or membership interest is exempt may always be challenged by the Board of Equalization (BOE) on several different levels.

1. If it is determined that the process of transfer from an individual owner to a corporation or LLC is for the purpose of avoiding the sales or use tax, then the tax may be imposed with any required penalties. The BOE has the option of looking at the entire transaction to make this determination. **The risk of penalty and tax resides solely with the purchaser.**

A properly organized transfer for a legitimate purpose may not be subject to these challenges.

STATUTE OF LIMITATIONS

The BOE, through regular audits and other sources, locates information on and investigates sales of vehicles, vessels and aircraft for which tax has not been reported and paid. If a taxpayer has not filed a return, the BOE generally has eight years from the due date of the return in which to issue a billing. If a taxpayer has filed a return but has not paid the tax due, the BOE generally has three years after the due date of the return, or the date the return was filed, whichever is later, to issue a determination letter.

SOURCES OF TRANSFER INFORMATION USED BY BOE TO DETERMINE THE TRANSFER OF OWNERSHIP

UNITED STATES COAST GUARD (USCG) 805.020

CUTS (Consumer Use Tax Section-California) also receives master registration files from the USCG on a monthly basis. Records are compared to the prior month, and any new transactions reflecting California purchasers or California hailing ports are identified for review.

DEPARTMENT OF HOMELAND SECURITY (CUSTOMS) 805.025

The United States Customs Service, operating under the Department of Homeland Security, is the resource for duty declarations completed by California residents returning to the United States from foreign destinations. See CPPM 814.000 for additional information.

COUNTY ASSESSORS' OFFICES — 58 OFFICES STATEWIDE 805.030

Counties where both documented vessels (as defined in CPPM 812.010) and aircraft are located provide the most recent property tax rolls to CUTS. These property tax rolls are compared to FAA and USCG information for any discrepancies in ownership information or indications that the taxpayer has provided the federal government with an address located outside of California. CUTS staff periodically visits these offices to obtain the information needed to send use tax inquiries.

MISCELLANEOUS LEADS 805.035

CUTS also obtains leads from other government agencies, district offices and from the public regarding any potential unpaid use tax relating to vehicles, mobile homes, vessels, and aircraft.

SOURCE INFORMATION 812.005

The major sources of information on vessel transfers are DMV and USCG. DMV submits undocumented vessel registration and transfer information by electronic tape (as it does for the Vehicle program) and the information is loaded into the Source Information File (SIF) for further review.

Information received from USCG on documented vessels, in the form of a CD-ROM, is compared to the previous quarter's information, and any new transactions showing either California purchasers or California hailing ports are flagged for review. If additional information is needed, Abstracts of Title can be ordered from USCG. Abstracts provide the chain of title and all owners' names, whereas the CD-ROM only provides the name and address of the current managing owner.

DOCUMENTED VESSEL 812.010

A documented vessel is a vessel for which the USCG has issued a valid marine certificate. "Documentation" is a world-wide registration system in lieu of all other registration requirements. Liberian registry or Panamanian registry are common terms used to describe the country of documentation under International Maritime Law.

All commercial vessels of at least five net tons displacement are required to be documented. However, pleasure vessels meeting the size requirement may be documented or state registered, at the owner's option. Documented vessels normally exceed twenty-eight and one-half feet (28.5') in length. Any vessel that will be used in international waters (outside the three-mile limit of California waters) must be documented with the USCG.

(Note: Sales and Use Tax Regulation 1661 defines any vessel that is 30 feet and more in length as mobile transportation equipment for sales and use tax purposes.)

PERSONS REQUIRED TO FILE RETURNS FOR DOCUMENTED VESSELS 812.015

Any person who purchases a vessel documented by the USCG for use, storage or other consumption in California shall file a Combined State and Local Consumer Use Tax Return for Vessels (the tear-out panel in Publication 79 also may be used for this purpose) and pay the use tax to the BOE.

MEASURE AND DUE DATE 812.020

The use tax due is measured by the total purchase price of the vessel, including cash, the market value of any property given in trade, the payment or assumption of any loan or any other valuable consideration given to the seller. The use tax rate is based on the district where the vessel is principally stored, used or otherwise consumed, such as the location where it is moored or berthed.

The return must be filed and tax paid (if applicable) by whichever period expires earlier:

1. On or before the last day of the calendar month following the month in which a return form is mailed or presented to the taxpayer, or,
2. The last calendar day of the twelfth month following the month in which the vessel was purchased.

Example: A vessel is purchased on January 15, 2016. Under number 1, a tax return mailed to the taxpayer on July 16, 2016 would have a tax due date of August 31, 2016. Under number 2 however, a tax return mailed to the taxpayer on May 12, 2016 would have a tax due date of January 31, 2017 (the last calendar day of the 12th month following the month the vessel was purchased) and penalty and interest would be due, even though the taxpayer did not receive the tax return until after the due date.

UNDOCUMENTED VESSEL 812.025

Any vessel which is not required to have, and does not have, a valid marine certificate issued by the USCG is an undocumented vessel. Under the Federal Boating Safety Act, an undocumented vessel must be registered in the state where it is principally used on the waters. DMV registers undocumented vessels for the State of California as an agent for the Department of Boating and Waterways (CAL-BOAT). If a state does not have a registration requirement, the USCG performs the function.

All undocumented vessels are issued a registration number, which must be displayed on the vessel. Registration numbers start with an abbreviation of the state — California "CF," Nevada "NV," etc. Undocumented vessels registered in California should have numbers that read "CF XXXX XX". The letters "CF" are followed by four numeric and two alpha characters.

PERSONS REQUIRED TO FILE RETURNS FOR UNDOCUMENTED VESSELS 812.030

Registration of an undocumented vessel with DMV constitutes filing a return. The use tax will be collected, if applicable, by DMV at the time of registration. (RTC section 6294.)

Any person who purchases an undocumented vessel for storage, use or other consumption in California from a person other than a vessel dealer holding a seller's permit, and who has not made application to

DMV, shall file a Combined State and Local Consumer Use Tax Return for Vessels and pay the use tax to the BOE.

MEASURE AND DUE DATE 812.035

The use tax due is measured by the total purchase price of the undocumented vessel, including cash, the market value of any property given in trade, and the payment or assumption of any loan or any other valuable consideration given to the seller. The use tax rate is based on the district where the vessel is principally stored, used or otherwise consumed, such as moored or berthed. Tax is due on or before the last day of the month following the month of purchase.

CUTS makes every effort to send timely returns to the taxpayer thereby allowing the taxpayer to make payment of the use tax without delinquency charges. In most cases, the information is received from USCG and processed by CUTS before the later period identified above. However, in situations where the certification with the USCG is delayed or never completed, sending of returns with delinquency charges already due is unavoidable. Under these circumstances, as with any other late return, the taxpayer may request relief of penalty per RTC section 6592.

EXEMPTIONS AND EXCLUSIONS 812.040

The following are common types of exemptions or exclusions for purchases of undocumented and documented vessels (see CPPM 820.000):

1. Commercial deep sea fishing.
2. Interstate and foreign commerce and 6-month test for nautical miles traveled.
3. Family transfer.
4. Not purchased for use in California.
5. Presumption of Use
 - a. 90-day test (exclusive of time of storage for shipment and shipping) and six-month test. Effective prior to October 2, 2004 and from July 1, 2007 to September 30, 2008.)
 - b. 12-month test (exclusive of time of storage for shipment and shipping). Effective from October 2, 2004 through June 30, 2007 and after September 30, 2008. This is the current test (2016).

FOREIGN REGISTERED VESSEL AND AIRCRAFT PROGRAM (FRVAP) 815.000

The purpose of this program is to collect the use tax on the storage, use or other consumption of vessels and aircraft that are documented or registered to an out-of-state address, but are being assessed personal property tax in California. CUTS reviews property tax rolls in comparison with information obtained from the FAA and the USCG. Any discrepancies such as changes in ownership or addresses recorded both in and out of state are verified for use tax paid.

Although both undocumented and documented vessels are assessed personal property tax, CUTS does not pursue use tax arising from the purchase of undocumented vessels through FRVAP since DMV, acting as an agent for the BOE, collects use tax measured by the purchase price at the time of registration. See CPPM 812.025 for information on undocumented vessels.

SOURCE INFORMATION 815.005

CUTS compares the Federal Aviation Administration and the USCG information with personal property information obtained from various county assessors. The compilation results in a list of possible leads which are further investigated by CUTS staff. County assessor records are reviewed for specific information regarding sales or use tax paid on the purchase.

EXEMPTIONS AND EXCLUSIONS

VEHICLES, VESSELS, AND AIRCRAFT 820.000

Purchases of vehicles, vessels, and aircraft for use in California are subject to either the sales or use tax unless a specific exemption or exclusion applies. Under certain circumstances purchases of vehicles, vessels, and aircraft may be exempted or excluded from tax. Any claim that the purchase is not subject to tax must be supported by satisfactory documentary evidence. Even though the evidence may vary considerably in each case, there must be sufficient documentation to substantiate the claim. The following section explains the exemptions and exclusions most common to consumer use tax programs. General provisions for use tax can be found under RTC sections 6202 and 6241. For specific exemptions, see the applicable law or regulation cited within the specific section.

PRESUMPTION OF PURCHASE FOR USE IN CALIFORNIA 820.005

A vehicle, vessel, or aircraft purchased outside of California which is subsequently brought into California is regarded as having been purchased for use in this state if the first functional use of the vehicle, vessel, or aircraft is in California. "Functional use" means use for the purposes for which the property was designed. Vehicles, vessels, and aircraft designed for personal use are "functionally used" when merely driven, sailed, or flown. Vehicles, vessels, and aircraft designed for a commercial or other special purpose are not "functionally used" until used for the purposes for which they were designed.

For vehicles, vessels and aircraft purchased outside of California, first functionally used outside of California and then brought into California, Regulation 1620, Interstate and Foreign Commerce, contains the presumptions for application of the use tax. When a California retailer delivers and transfers title to a purchaser out of state and does not charge tax, the use tax may still be due from the purchaser.

Due to changes in the law, there are two different tests established for determining whether a vehicle, vessel, or aircraft purchased and first functionally used outside California, is considered to have been purchased for use in this state.

A vehicle, vessel, or aircraft purchased and first functionally used outside of California will be subject to either the "90-Day and Six-Month Principal Use Test," or the "12-Month Test" depending upon the purchase date. The following table illustrates the application of each of the two test periods based on the purchase date:

Purchase Date

Test Period

October 2, 2004 – June 30, 2007 12-Month Test

July 1, 2007 – September 30, 2008 90-Day Test

On or after October 1, 2008 12-Month Test

Note: If a binding purchase agreement was completed prior to October 2, 2004, or between July 1, 2007, and September 30, 2008, the purchase will be subject to the "90-day test." The test period will commence on the date of purchase, generally the date of out-of-state delivery.

PRESUMPTION OF PURCHASE FOR USE IN CALIFORNIA A 820.005

APPLICATION OF TEST PERIODS

90-Day Presumption and Six-Month Principal Use Test

When a vehicle, vessel, or aircraft is purchased and first functionally used outside of California, the vehicle, vessel, or aircraft will be presumed to have been purchased for use in California if it is brought into California within 90 days after its purchase, exclusive of any time of shipment to California or time of storage for shipment to California, unless the vehicle, vessel, or aircraft is used or stored outside of California one-half or more of the time during the six-month period immediately following its entry into California.

12-Month Test

When a vehicle, vessel, or aircraft is purchased and first functionally used outside of California and is brought into California within 12 months from the date of its purchase, it is a rebuttable presumption that it was acquired for storage, use, or other consumption in California, and subject to use tax if any of the following occur:

1. The vehicle, vessel, or aircraft was purchased by a California resident as defined in section 516 of the California Vehicle Code (effective January 1, 2010, a California resident is defined to include a closely held corporation if 50 percent or more of the shares are held by shareholders who are California residents, and effective January 1, 2011, to include, but is not limited to, a closely held limited liability company if 50 percent or more of the membership interests are held by members who are California residents), or

In the case of a vehicle, the vehicle was subject to registration in California under Chapter 1 (commencing with section 4000) of Division 3 of the Vehicle Code during the first 12 months of ownership, or

In the case of a vessel or aircraft, the vessel or aircraft is subject to property tax in this state during the first 12 months of ownership, or

If purchased by a **nonresident of California**, the vehicle, vessel, or aircraft is used or stored in this state more than one-half of the time during the first 12 months of ownership.

This presumption may be rebutted if the purchaser can provide satisfactory documentary evidence that the vehicle, vessel, or aircraft was purchased for use outside California during the first 12 months of ownership. This evidence may include, but is not limited to, proof of registration of the vehicle, vessel, or aircraft with the proper out-of-state authority. In determining whether the presumption has been rebutted, all relevant evidence should be considered in its entirety. Other possible evidence that may indicate that the property was not purchased for use in California may include, but is not limited to:

Proof of payment of property tax to another state,

Apartment lease, rental agreement, or other evidence showing residence in another state,

Proof of change in employment status, or

Anything else that will reasonably establish that at the time of purchase, the purchaser did not intend to use the vehicle, vessel, or aircraft in California.

In some instances, the purchaser may claim that at the time of purchase, the intent was not to use the vehicle, vessel, or aircraft in California, but subsequent circumstances changed the purchaser's original intent (e.g. change in job assignment). To overcome the presumption that the vehicle, vessel, or aircraft was purchased for storage, use or other consumption in this state, the following two factors must be present: (1) at the time of purchase, the purchaser did not contemplate bringing the property to California for use in the state, and (2) the subsequent change of intent was beyond the control of the purchaser.

In addition, a vessel or aircraft the purchase of which is subject to the 12-month test that is brought into California for the exclusive purpose of repair, retrofit, or modification shall not be deemed to have been acquired for storage, use, or other consumption in this state provided either of the following apply:

in the case of a vessel, the work is performed by a repair facility that holds an appropriate permit issued by the board and is licensed to do business by the city, county, or city and county in which it is located if the city, county, or city and county so requires, or

in the case of an aircraft, the work is performed by a repair station certified by the Federal Aviation Administration or a manufacturer's maintenance facility.

The presumption for vehicles may be controverted by documentary evidence that the vehicle was brought into this state for the exclusive purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less. The 30-day period begins when the vehicle enters this state, includes any time of travel to and from the warranty or repair facility and ends when the vehicle is returned to a point outside the state. The documentary evidence shall include a work order stating the dates that the vehicle is in the possession of the warranty or repair facility and a statement by the owner of the vehicle specifying the dates of travel to and from the warranty or repair facility.

Generally, when a taxpayer claims that a vehicle or undocumented vessel was not purchased for use in California and the applicable test period has not yet expired, it is Board of Equalization (BOE) policy to permit registration with the Department of Motor Vehicles (DMV) without the payment of California use tax. In this situation, the BOE issues a BOE-111, Certificate of Vehicle, Mobile Home or Commercial Coach Use Tax Clearance, or BOE-111-B, Certificate of Vessel Use Tax Clearance. Clearance certificates are issued subject to certain documentary requirements, with the understanding that the taxpayer is required to provide additional documentation to the BOE to support his or her claim at the end of the test period. See CPPM section 825.000.

COMMERCIAL DEEP SEA FISHING 820.015

The storage, use, or other consumption in this state of watercraft principally used in commercial deep sea fishing operations outside the territorial waters of California by persons who are regularly engaged in commercial deep sea fishing are exempt from the use tax. Regulation 1594 establishes a two-step test to determine if the exemption applies.

First, the watercraft must be used by persons who are regularly engaged in commercial deep sea fishing. Second, the watercraft itself must actually be used principally in commercial deep sea fishing operations outside the territorial waters of this state, using a test period of 12 consecutive months beginning with the first operational use of the watercraft. 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. "Principal use" means that over 50 percent of the time spent in total operation must involve commercial fishing outside the territorial waters of this state. There is a rebuttable presumption that a person is not regularly engaged in the business of commercial deep sea fishing if the person has gross receipts from commercial deep sea fishing operations that total less than \$20,000 a year.

Note: It is not material to the application of tax whether a vessel is documented with the USCG or undocumented and registered with DMV.

FAMILY TRANSFERS 820.025

There is an exemption from the use tax when the person selling a mobile home, commercial coach, vehicle, vessel, or aircraft is a parent, grandparent, grandchild, child, or spouse of the purchaser or, on or after January 1, 2005, is the registered domestic partner of the purchaser as defined in Family Code section 297, or the brother or sister of the purchaser if both are minors (under the age of 18) and related by blood or adoption; and the seller is not engaged in the business of selling the type of property for which the exemption is claimed.

This exemption does not extend to stepparents, step-grandparents, step-grandchildren, stepsiblings, or stepchildren. There must be a legal adoption for these relations to fall under this specific tax exemption. Claimants must provide documentation to show proof of the relationship and age (if the transfer is between minors).

Department of Housing and Community Development (HCD) or DMV may allow the transfer of vehicles, mobile homes, vessels, or aircraft between qualified family members without requiring a use tax clearance from the BOE (See CPPM section 825.035).

GIFT 820.030

The gift of a vehicle, vessel, or aircraft is not subject to use tax. To qualify as a gift, the transfer of a vehicle, vessel, or aircraft must be made without any consideration being exchanged in order to obtain the vehicle, vessel, or aircraft. Examples of consideration include cash, credits, receipts, the fair market value of any trade, including trades of equal value, or the assumption of any liability. All relevant evidence supporting the gift should be considered. Although not determinative, the applicant's statement that it was a gift should be supported by a signed statement from the previous owner, or, in the case of a corporation, corporate minutes.

Under certain circumstances, an individual may wish to transfer registration of a vehicle or vessel from a company or corporate name to his or her own. The individual may or may not own the entity in question. Fully depreciated vehicles no longer needed by the company or transfers for insurance purposes are among the most common reasons for transfer. In all cases, these transfers must meet the criteria of a transfer without consideration before an exemption can be granted

INVOLUNTARY TRANSFERS 820.065

Tax does not apply to a repossession of property by a seller from a purchaser who has not completed repayment. In order to receive the exemption, the applicant must provide documentation, such as a certificate of repossession.

CORPORATE, PARTNERSHIP, AND LLC DISSOLUTION 820.070

Receiving property as part of the final distribution of corporate, LLC, or partnership assets is normally a nontaxable transfer if the distribution is in proportion to the individual's ownership interest in that entity and the entity receives no consideration. The entity will be deemed to have received consideration when the individual assumes the outstanding liability still owed on the property. The amount of the assumption would be the measure of tax. The taxpayer should provide a statement from the lender which identifies the outstanding balance at the time of assumption. As proof of ownership interest, supporting evidence in the form of partnership agreements or corporate dissolution papers should be provided.

TRANSFERS TO COMMENCING CORPORATIONS, LLC'S OR PARTNERSHIPS 820.080

The contribution of property to a commencing corporation, LLC, or partnership solely in exchange for an interest in the LLC, partnership or corporate stock is not a sale and not subject to tax. If consideration is received in the form of another asset in exchange, or the assumption of indebtedness, the transfer would be subject to tax. Evidence in the form of partnership agreements or articles of incorporation will be needed to verify the exemption.

CAPITAL CONTRIBUTIONS 820.085

The contribution of property to a corporation by a shareholder is exempt if the corporation merely credits a donated capital or other capital account. The transfer is regarded as a contribution of capital and it is immaterial that the value of the shares held by the person contributing the property may be enhanced. Copies of the corporation's journal entries should be provided to verify that a capital account is credited.

TRANSFERS TO TRUSTS 820.090

Transfers of vehicles, vessels, aircraft, or mobile homes to revocable trusts are exempt under certain circumstances. The majority of living trusts are revocable and the following rules would apply. In order to qualify for this exemption, all of the following must occur:

1. The seller has an unrestricted power to revoke the trust.
2. The sale does not result in any change in the beneficial ownership of the property.
3. The trust provides that upon revocation, the property will revert wholly to the seller.
4. The only consideration for the sale is the assumption by the trust of an existing loan for which the tangible personal property being transferred is the sole collateral for the assumed loan.

For those trusts that are not revocable or if the transfer does not meet the above criteria, there is no special exemption for property transferred merely because the transferor (settlor) is both the creator of the trust (trustor) and administrator of the trust (trustee). A trust is a "person" under the Sales and Use Tax Law and any transfer to the trust for a consideration would normally be subject to tax.

To properly document transfers to a trust, you will need to obtain copies of the trust agreement which identify:

the parties involved and their signatures.

the property being transferred. If the property is not clearly identified in the trust agreement, a statement (including the I.D. number) should be obtained that describes the property included in the transfer.

the assumption of liabilities.

whether or not the trust is revocable.

PENALTY AND INTEREST 830.005

Interest and/or penalties apply to the use tax where:

1. A purchaser is delinquent in transferring registration of the vehicle, undocumented vessel, or mobile home through DMV or HCD. The purchaser is subject to penalty, and/or interest when application for registration with DMV or HCD is not made within 30 days of the change in ownership, even if the change in ownership was never registered with DMV or HCD, as in the case of some multiple transfers (RTC section 6484 and 6485).
2. A purchaser is late in filing a return with the BOE (RTC section 6591).
3. A purchaser underpaid or failed to pay the tax to DMV, HCD or the BOE (RTC section 6511).
4. A purchaser of a vehicle, vessel, or aircraft registers it outside the State of California for the purpose of evading the payment of taxes. A 50 percent penalty of any tax determined to be due on the sales price of the vehicle, vessel, or aircraft may be assessed (RTC section 6485.1). All elements of fraud must be proven to assess this penalty.

Note: In certain cases, involving brokers of vehicles, vessels and aircraft, a 40% penalty may apply under specified criteria (see RTC section 6597).

REQUEST FOR RELIEF OF PENALTY AND/OR INTEREST 830.010

Taxpayers may request relief from any penalty assessed on use tax by filing a written request signed under penalty of perjury, stating the facts upon which the claim for relief is based.

Sales and Use Tax Regulations

ARTICLE 7. SPECIFIC KINDS OF PROPERTY AND EXEMPTIONS GENERALLY

REGULATION 1595

Regulation 1595. OCCASIONAL SALES—SALE OF A BUSINESS—BUSINESS REORGANIZATION

6) TRANSFER OF SHARES IN A CORPORATION. The sale of stock of a corporation is not a sale of tangible personal property and is not subject to sales tax. A stock purchase is not a purchase of tangible personal property and is not subject to sales or use tax notwithstanding the fact that the stock purchase may be treated as an asset acquisition for federal income tax purposes pursuant to Internal Revenue Code Section 338.

Each case should be examined on an individual basis to see if a Sales or Use Tax will apply.

Please consult appropriate counsel when considering the sale, registration or purchase of a vessel.

END