STATE OF CALIFORNIA

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February 8, 2000

Re: The Applicability of the "Vessel" Exemption Set Forth in Section 3(l) of Article XIII of the California Constitution to the Vessels – the " " and the " "

Dear Mr. :

This is in response to your request on behalf of your client the Limited Partnership (S) for an opinion on the potential applicability of the exemption set forth in section 3(l) of article XIII of the California Constitution to two vessels. The two vessels are known as the " " and the " " and have their homeport in , California. S is the lessee of both these vessels and uses them in its business of launching customer-owned satellites into orbit. Once the satellites have achieved orbit, the customer typically sells them to third party purchasers.

In our opinion, both the and the are "vessels" and actively involved in the "transportation of freight or passengers" within the meaning of section 3(l) of article XIII. Nevertheless, they are not engaged in qualifying transportation activities on a full-time basis; the two vessels also are used for rocket assembly and launching purposes. Based upon the authorities set forth below, when, as here, appropriately sized vessels are <u>not</u> wholly engaged in qualifying transportation activities, they will qualify for the exemption provided by section 3(l) only if they are <u>primarily</u> engaged in such activities. In other words, a vessel is "engaged in the transportation of freight or passengers" within the meaning of the constitutional exemption only if it is "primarily engaged" in such qualifying transportation.

While the cases indicate that the primary intention of the operator of a vessel need not be transportation, in order for the vessel to be found to be primarily engaged in qualifying transportation it must spend <u>more than 50 percent of its time</u> in such activity. Thus, as set forth in detail below, the and the will only qualify for the exemption provided by section 3(l) of article XIII of the California Constitution if they spend a majority of their time engaged in <u>transportation activities</u> as opposed to <u>rocket assembly and launch-related activities</u>. Once this is determined, however, the exemption either must be granted in its entirety or denied in its entirety. There is no authority indicating that an assessor may prorate the exemption based upon time spent. What amount of time is spent in transportation and what amount is spent in other activities are questions of fact to be determined in the first instance by the county assessor.

Background Information

The was specially built to transport rockets as well as personnel and equipment used in the launch of a satellite. It is sometimes referred to as the "Assembly and Command Ship." The formerly was a mobile offshore oil platform; now, it is used to launch satellites into orbit. It is sometimes referred to as the "Launch Platform."

In a letter dated August 1, 1997 to Mr. Gary Jugum of the Board legal staff, you describe the two vessels as follows:

> 1. Assembly and Command Ship (ACS) – a self-propelled vessel, the primary purpose of which is to communicate remotely with the launch platform and ILV [integrated launch vehicles or rockets] as wells as transport equipment and personnel to the launch site. The ACS is the intelligence center for both vessels and controls the launch sequence . .
>
> 2. Launch Platform – a self-propelled vessel that was formerly a mobile offshore oil platform. The launch platform is used to transport personnel and the ILV containing the satellite from , California, to the launch site. The ILV is ultimately launched from this vessel . . . .

In a letter to the County Assessor's Office dated April 9, 1999 you provide the following summary of S 's business and operations:

> S intends to provide space launch services to satellite owners from a launch site located along the Equator in the international waters of the Pacific Ocean. At no time will S own the satellites. These services entail the transportation of satellites and launch support equipment (both of which are owned by S 's customers) from to the launch site and ultimately, with respect to the satellites, to a fixed orbital position in space. These services also entail the transportation of employees of the customer to and from the launch site. The transportation service provided by the vessels is available to any party wishing to launch an appropriate Satellite from the platform for the established fee. The Assembly Command Ship and the Launch Platform are integrated vessels and were built for an intended purpose. We concede that these vessels are unique, as they have no purpose other than to transport satellites, equipment and customers. (Emphasis added.)

As to ownership of the satellite to be placed into orbit, your letter to Mr. Jugum of December 9, 1996 states as follows:

> The satellite that will be launched is owned by S 's Customer (the Customer)[1] . . . .

[1] For purposes of this opinion, I assume that, in launching the satellite into orbit for the prospective third party purchaser, S and the customer are not acting within the scope of a partnership, joint venture, or

> The Customer, or the Customer's agent, transports the satellite to Long Beach to be loaded onto the Rocket and subsequently launched into space from the launch site. The Customer retains title to the satellite throughout the launch process.

The primary customer-owned "freight" carried aboard the is the satellite or payload. Prior to placement in orbit, the customer owns the satellite. When orbit is achieved, however, the customer typically sells the satellite to a third party purchaser. It appears that the customer is not obligated to pay S if the satellite does not reach its designated orbit.

Finally, I note that in the attached partial copy of a sample S contract, section 3.5 states, *inter alia*, that S shall, "Transport spacecraft, support equipment, and personnel to/from the launch site." You indicate that the launch site is generally located along the equator. Thus, the two vessels both transport the satellite payload, the necessary equipment, and the crew and passengers to the equator where they launch the satellite into orbit on behalf of the customer.

Law and Analysis

Section 3(l) of article XIII of the California Constitution provides that "vessels of more than 50 tons burden in this State and engaged in the transportation of freight or passengers" are exempt from property taxation. Section 209 of the Code of Revenue and Taxation provides that, "The exemption of certain vessels from taxation . . . is as specified in subdivision (l) of Section 3 of Article XIII of the Constitution." Section 130(a) of the Code of Revenue and Taxation defines "vessel" to include "every description of watercraft used or capable of being used as a means of transportation on water, but does not include aircraft."

There does not seem to be any dispute that both the " " and the " " are vessels, albeit unusual ones. They are self-propelled watercraft, registered as vessels, have captains and crews, etc. Nor does there seem to be any dispute as to tonnage. The issue seems to be as follows: are these vessels "engaged in the transportation of freight or passengers" within the meaning of the constitutional exemption?

For purposes of this exemption, the word "freight" has been interpreted as denoting "property transported by a carrier from a consignor to a consignee;" which transport of goods is 'for hire.'" *Dragich v. County of Los Angeles* (1939) 30 Cal.App.2d 397, 398; *Smith-Rice Heavy Lifts, Inc. v. County of Los Angeles* (1967) 256 Cal.App.2d 190, 194.) Likewise, the term "passengers" "implies carriage for hire and it further appears that the word . . . is quite generally used in contradistinction to the word 'guest.'" (*Ibid.*) Thus, the phrase "engaged in the transportation of freight or passengers" has been interpreted by the courts to mean "engaged in the transportation of property or persons for hire." (*Ibid.)*

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agency relationship. I also assume that S is neither an *alter ego* nor a "mere instrumentality" of the customer. I have not, however, been given sufficient information to confirm or deny these assumptions.

In Dragich, supra, the court held that certain fishing boats were engaged in fishing and "were not engaged in any other business." The only fish they hauled -- or transported -- were owned by them until sold upon their return to their homeport. Thus, as the fish were not being transported for a third party consignor for hire, they did not constitute "freight." The decision in Crivello v. County of San Diego (1942) 50 Cal.App.2d 713, is to the same effect. In that case, the court found that two fishing boats were not engaged in the transportation of property or persons for hire under the following facts:

> [T]he boats involved were engaged in the fishing industry. After leaving port they proceeded many miles distant to the fishing grounds, manned by a fishing crew, and carrying only fishing equipment and sufficient food to supply the crew until the return to port with the catch of fish.

In *Alalunga Sport Fishers, Inc. v. County of San Diego* (1967) 247 Cal.App.2d 663, on the other hand, tax exemption was held to apply to certain sport fishing vessels of the required tonnage that carried passengers from a particular dock in the San Diego harbor to various fishing grounds. In other words, unlike the case in *Dragich* and *Crivello*, in *Alalunga* the fishing boat was carrying – not crew members – but third party passengers for hire to fishing grounds; and then carrying them back to homeport with their catch. In so holding, the court stated that:

> In dealing with the distinction between one being carried in an automobile for compensation and one carried without compensation, our courts have used the word "passenger" to denote the former, "guest" to denote the latter." [Cites omitted.}
>
> Primarily, [the vessel] is used for the conveyance of persons, other than its owner, officers and crew. The persons so conveyed are not guests, since they pay for being conveyed, but are passengers.

In the subsequent decision in *Smith-Rice Heavy Lifts, Inc. v. County of Los Angeles* (1987) 256 Cal.App.2d 190, 198-199, the court elaborated upon the court's holding in *Alalunga* as follows:

> Although the passengers did not know their exact destination when they left the dock, they did know that following a day's fishing from the deck of the ships, they would be returned to the same dock from which they had departed . . . .
>
> It is beyond reasonable doubt that the persons boarding the boats involved in *Alalunga* were passengers who, for specified monetary consideration, were furnished transportation thereon by water to and from various points on the ocean as conditions favorable to fishing made appropriate.

In *Star and Crescent Boat Company v. County of San Diego* (1958) 163 Cal.App.2d 534, the court concluded that tugboats employed as the means of locomotion of oil barges owned by the

same company from Los Angeles to San Diego were engaged in the transportation of freight. Even though by so doing the tugboats could be characterized as transporting other vessels, they were also transporting the barges' oil cargo -- and, thus, "freight" -- within the meaning of the constitutional exemption.[2]

In this case, while the vessels are engaged in the business of launching rocket-carrying satellites into orbit, in order to carry out this activity it is necessary to carry the satellite payload, customer-owned support equipment, and customer personnel to the launch site at the equator. Apparently, it is more economical to launch satellites into Earth orbit from the equator. Thus, the transportation of such equipment and personnel to that location as a launch site is dictated not only by the contract between S and its customers, but also by the economics of the transactions.

In my opinion, inasmuch as it is necessary for the S vessels to transport both customer property and personnel to the launch site in order to carry out their duties, that property constitutes "freight" and those persons constitute "passengers." In other words, this case is like *Alalunga*, not *Dragich.* Here, as well as transporting its own crew and equipment to the launch site, the two vessels must transport both customer equipment – primarily (but not exclusively) the satellite – and customer personnel. This transportation of the customer's equipment and personnel to the launch site is as necessary in this case as was transporting the passengers to the fishing grounds in *Alalunga*.[3]

The parties could have structured their contract differently. For example, S could maintain a permanent launching site and eschew the use of any vessels. Then, the customer would be responsible for finding another carrier to transport the satellite, etc., to that launch site. In that case, there would be no question but that the vessel that transported the customer's satellite, equipment, and personnel to the launch site would be engaged in the transportation of freight and passengers for hire. The confusion that arises in this case is due to the fact that the two S vessels also serve as a launching site. In other words, they do double duty – they both transport the freight and passengers to the launch site, and then serve as the launch site.[4] Thus, it cannot be said that the vessels are used exclusively for transportation purposes. The submitted material, however, does not provide any facts indicative of the ratio of time spent by the vessels in qualifying transportation activities to total time.[5]

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[2] As the tugboats spent a portion of their time in nonexempt dredging activities, the trial court "prorated the exemption pursuant to the percentage of time spent by each tugboat under the affreightment contract to its total time spent in operation for the calendar years in question." (*Ibid.* at 535-536.) As the taxpayer did not appeal this proration, however, the court of appeal did not discuss it.

[3] While no specific compensation is mentioned as to such transportation separate and apart from the compensation for placing the satellite into orbit, that is no impediment to finding that it was "for hire." (See *Audrey McCann v. Hoffman* (1937) 9 Cal.2d 279.) Clearly, neither the transportation of the passengers nor the freight is gratuitous. The S vessels do not go on "pleasure trips."

[4] While the serves as the launch platform, the serves as a floating rocket assembly factory while in port and as a mission control facility for commanding launches at sea.

[5] While the transportation activities can be said to be incidental to the rocket-launching activities, it nonetheless is unquestionably true that it cannot be said that the rocket launching is merely incidental to the transportation. (See *Cedars of Lebanon Hospital v. County of Los Angeles* (1950) 35 Cal.2d 729.)

While the constitution does not expressly require that exempt vessels be used "exclusively" for transportation purposes[6], the cases speak in terms of "primary," "principal," or "predominant" use. In the Star and Crescent Boat Company opinion, there were three tugboats; the ratio of their time spent in exempt transportation uses to their total operating time ranged from a high of 96 percent to a low of 83 percent. The appellate court found that, "it is apparent that the tugs of plaintiff boat company both as to revenue and as to time were primarily engaged in the transportation of petroleum products." (Ibid. at 537.) In other words, the court concluded that if the time apportioned to exempt activities was at least 83 percent, then it was primarily engaged in such exempt activities and, thus, eligible for the property tax exemption.

In Alalunga, supra at 664, the court speaks in terms of the vessel being "principally" used for sportsfishing, etc. In the case of County of Los Angeles v. Craig (1940) 38 Cal.App.2d 58, 62-63, the court states that: "We believe that the true test of whether a vessel is 'engaged in the transportation of freight or passengers' within the meaning of [the exemption] depends upon whether such vessel is regularly used for such purpose . . . ." While the appellate court in Smith-Rice Heavy Lifts ultimately found that certain barges were not engaged in any qualifying transportation activities, the trial court concluded that, "appellants' barges would qualify for the constitutional exemption if their principal operations during the chosen 'sample periods' were of the [freight transportation] variety . . . ." The trial court apparently based its determination of whether or not transportation was a barge's "principal operations" based upon a ratio of "days used for transporting cargo" versus "total days in use." In other words, if the vessels spent a majority of their time in transporting cargo, they would qualify for the exemption.

The constitutional exemption for "museums that are free and open to the public" is similar to the instant exemption in that the word "exclusive" is not employed. In that context, the appellate court in Fellowship of Friends, Inc. v. County of Yuba (1991) 235 Cal.App.3d 1190, 1196 held as follows:

> We . . . agree with the trial court that in ordinary parlance a museum is a building whose "predominant purpose" is to house and display objects of lasting value. Property used "for a museum must be used primarily to house and display objects of lasting value. This does not preclude other uses, but requires the use as a museum to be primary. (Emphasis added.)

Based upon the above authorities, it is my opinion that when, as here, an appropriately sized vessel engages only partially in qualifying transportation activities, it will qualify for the exemption provided by section 3(l) of article XIII only if the vessel is primarily engaged in such activities. In other words, a vessel is "engaged in the transportation of freight or passengers" within the meaning of the constitutional exemption only if it is "primarily engaged" in such qualifying transportation. While the sportsfishing cases indicate that the primary intention of the

[6] Board Property Tax Annotation 860.0021 states that the exemption requires exclusive use and that the vessels not be used "as part of a nontransportation project." I have examined the opinion underlying this annotation and the authorities cited therein and, in my opinion, they do not support these statements. Thus, I am ignoring this annotation and recommending that it be deleted.

operator of a vessel need not be transportation[7], in order for the vessel to be found to be primarily engaged in qualifying transportation it must spend more than 50 percent of its time in such activity. While the case authority indicates only that a vessel used 83 percent of the time in qualifying activities may be found exempt, in my opinion the use of the word "primary" in the cases is best interpreted in this context to exempt those vessels used more than 50 percent of their time in qualifying activities.

Thus, in my opinion, the and the will only qualify for the exemption provided by section 3(l) of article XIII of the California Constitution if they spend a majority of their time engaged in transportation activities as opposed to rocket assembly and launch-related activities. Once this is determined, however, the exemption must either be applied 100 percent or denied 100 percent. There is no authority indicating that an assessor may prorate this exemption based upon time spent. What amount of time is spent in transportation and what amount is spent in other activities are questions of fact to be determined by the county assessor.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity. If you have any additional questions, please call Robert Lambert at (916) 324-6593.

Sincerely,

/s/ Robert W. Lambert

Robert W. Lambert
Senior Tax Counsel

RL:tr
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cc: Mr. Dick Johnson, MIC:63
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[7] In those cases, the primary intention or goal of the operators of the vessels was to provide good fishing for their customers; the transportation was both necessary and incidental to that goal. Likewise in this case, an economical satellite launch is the goal, but the transportation to the equator is both necessary and incidental to that goal.