



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
TELEPHONE (916) 324-2640
FAX (916) 323-3387
www.boe.ca.gov

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TIMOTHY W. BOYER
Interim Executive Director

November 24, 2003

Re: Vessel Valuation –Inclusion of Sales Tax and Freight Charges

Dear Mr. _____ :

This is a response to your letter of July 24, 2003 to Assistant Chief Counsel Kristine Cazadd in which you asked us to clarify whether sales taxes and freight charges are appropriate to include in the valuation of a vessel for purposes of property tax. We apologize for the delay in responding to your letter, unfortunately, other previously scheduled matters have occupied our time. Based on our review of the applicable regulations and appraisal standards for vessels, it is our view that sales and use taxes, as well as freight charges, should be included in the valuation of a vessel, where appropriate. Generally, “appropriate,” means that when such charges actually were, or would be charged in order to complete delivery of personal property to the customer, they should be included in the appraisal value, i.e. its fair market value.

You have provided the following facts: In July 1999, you purchased a new sailboat from a dealer in Vancouver, British Columbia. The vessel was delivered to you in the State of Washington. The purchase price included “transportation, commissioning, applicable taxes and duties.” For the year following purchase, the vessel remained in the “Pacific Northwest,” extensively cruising in Washington and Canadian waters. The vessel is registered with the U.S. Coast Guard. Following an inquiry in 2001 from the Board’s Sales and Use Tax Department, the Board subsequently granted you an exemption from sales and use taxes related to the purchase of the vessel. In August 2000, you sailed the vessel to California and moored it in a marina located in _____ County. You have asked the following:

1. Although you did not pay California sales or use tax on the purchase of the vessel, is it appropriate for the county assessor to attribute such taxes when establishing the taxable value of the vessel?
2. Although you did not pay freight charges after the initial purchase, is it appropriate to include freight charges in the taxable value of the vessel?

Law and Analysis

Pursuant to Revenue and Taxation Code section¹ 405, an assessor is authorized to assess the owners and/or the persons in possession or control of taxable personal property, such as a

¹ Unless otherwise indicated, the term “section” refers to the Revenue and Taxation Code.

sailboat. The basic principles of appraisal apply to the valuation of vessels, just as they do to other personal property and real property. However, unlike real property, personal property is not subject to the base year value limitations of Article XIII A of the California Constitution. Thus, for purposes of California property taxation, vessels are valued at their fair market value every year as of the January 1 lien date.

Assessor’s Handbook Section 576, *Assessment of Vessels* (AH 576), provides a guide for the discovery, classification, and valuation of vessels. The assessor should consider the three approaches to value (the cost, comparative sales, and income approaches) when determining the market value of a vessel. Although all three approaches to value should be considered, the use of all three may not always be appropriate due to the nature of property, its market, and the availability of data. [AH 576 at p. 11, attached] This is supported by Property Tax Rule 3, *Valuation Approaches*, which states in part:

“In estimating value as defined in section 2, the assessor shall consider one or more of the following [approaches to value], as may be appropriate for the property being appraised.”

, Senior Appraiser at the County Assessor’s office, acknowledges he reviewed both cost and comparable sales data when establishing the value of your 2000 vessel. AH 576 advises “[r]eplacement cost new, in the case of a new or nearly new vessel and when considered along with normal depreciation, will be a strong indication of market value in the case of vessels that continue to be manufactured.” [AH 576, at p. 12, attached]. The comparable sales approach utilizes the sales price of comparable property as an indicator of current fair market value as of a certain date. For vessels, nationally published value guides that reflect the current market price for comparable vessels can be used as a basis for determining market value when no comparable sales in the market area can be found. [AH 576 at p. 13, attached].

1. Although you did not pay California sales or use tax on the purchase of the vessel, is it appropriate for the county assessor to attribute such taxes when establishing the taxable value of the vessel?

Yes, it is appropriate for a county assessor to include sales or use tax in the valuation of a vessel under any approach to value, even if you received an exemption from sales tax at the time of the original purchase. The current fair market value is measured by what it would cost to place the vessel in the hands of a consumer as of the lien date. Sales tax would ordinarily apply to the sale of the vessel in California pursuant to section 6275 and Sales and Use Tax Regulation 1610. Therefore, sales taxes should be included by the assessor when subsequently establishing the taxable value of a vessel.

Assessors’ Handbook section 502, *Advanced Appraisal* (AH 502), provides this advice regarding the costs properly considered in the cost approach to value:

“AH 501 discusses the concept that costs, for appraisal purposes, may be thought of as ‘full economic costs’Full economic costs consist of all expenditures necessary to place the completed property in the hands of the buyer or ultimate consumer.” [AH 502 at p. 13, attached].

Full economic cost includes direct costs, indirect costs, and entrepreneurial profit. Direct costs are generally thought of as those expenditures required for the labor and materials necessary to develop and construct the property. Indirect costs are generally thought of as those expenditures for items other than labor and materials typically incurred in bringing the property to a finished state. In response to your inquiry, indirect costs include sales or use taxes where payment of such taxes is necessary to place the property in the hands of the consumer. [Assessors' Handbook section 501, *Basic Appraisal* (AH 501), at pp. 75-76]. Specifically, sales tax is considered a direct cost. Assessors' Handbook section 504, *Assessment of personal Property and Fixtures* (AH 504) states:

The general rule in determining market value is that where price is the basis of value, sales/use tax, freight, and installation cost are elements of that value. These elements should be included in full economic cost since they are part of value when they are paid. Moreover, if these costs would have been applicable to a similar consumer using the equipment at a similar *trade level*, they may be assessable even when not paid. The costs apply at the same rate as those that apply to a similar consumer, whether actually paid or not. [AH 504 at pp. 54-56, attached]

Where a value guide is used for a comparative sales approach, “[s]ales tax, an element of value, should be added to the listed value to arrive at full cash value for property tax purposes.” [AH 576 at p. 13, attached] That is because the sales tax would be added to the sales price in order to complete delivery of the boat upon sale; thus, it is part of the fair market value.

Therefore, it has been the longstanding opinion of the Legal Department that sales tax which would apply to the sale of the vessel as of the lien date is properly included as a cost in the full cash value for property tax purposes under both appraisal approaches to value.

2. Although you did not pay freight charges after the initial purchase, is it appropriate to include freight charges in the taxable value of the vessel?

Yes, it is appropriate to attribute freight and transportation charges to the original cost of the new vessel which is then subject to depreciation on subsequent lien dates under the cost approach used by the _____ County Assessor. [AH 576 at p. 12, attached]. The freight charges are indirect costs which were part of the original full economic cost of the boat when you purchased it from the Canadian dealer for delivery in the State of Washington. The inclusion of the freight charges in the “full economic cost” of the boat is based on the same reasoning as in the above discussion regarding the inclusion of sales taxes.

As noted previously, AH 504 states, in relevant part, that freight charges are among those elements that should be included in full economic cost whether they are actually paid or if these charges would have been applicable to a similar consumer using the equipment at a similar *trade level*, even when not paid. [AH 504 at p. 56, attached]

Therefore, it is the opinion of the Legal Department that it is appropriate to attribute actual freight and transportation charges to the original cost of the new vessel. The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of

November 24, 2003

the Board of Equalization based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Melanie M. Darling

Melanie M. Darling
Senior Tax Counsel

Enclosure

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cc:

County Assessor

Mr. David Gau, MIC:63
Mr. Dean Kinnee, MIC:64
Ms. Mickie Stuckey, MIC:62
Ms. Jennifer Willis, MIC:70