

Table of Contents

Chapter 1 **1**

 Introduction 1

 Definitions 1

 Information Services 4

 Title Histories 4

 Electricity 4

 Leased/Contract Employees 5

 Surveys 5

 Fuels 5

 Pre-Audit Research 6

 Entrance Conference 6

 Tour of Premises 7

 Internal Controls 7

 Tax Reports 7

Chapter 2 **8**

 Sales and Deductions 8

 Certification Of Documentation 9

 Purchases 10

 Component Parts 12

 Shrimp Boats and Fishing Boats 13

 Shipyards/Vessel Repairmen 13

Chapter 3 **15**

 Services, Rentals and Leases 15

 Bare Rentals/Leases Versus Service 17

 Vessels Used in Interstate Commerce 18

 Related Service Companies 19

Disclaimer: This manual has been written for the purposes of a training tool and as a reference guide for the auditor. Any references to taxability, administrative policies, laws, and rules are subject to change due to administrative hearings and actions of the courts or legislature. While the content of the manual is current as of the revision date, the reader is responsible for any changes occurring after this date and should verify the current status of any information by contacting the Comptroller of Public Accounts toll free at 800-252-5555.

Chapter 1

- Introduction
- Definitions
- Information Services
- Title Histories
- Electricity
- Leased/Contract Employees
- Surveys
- Fuels
- Pre-Audit Research
- Entrance Conference
- Tour of Premises
- Internal Controls
- Tax Reports

Introduction

The marine industry is composed of trades and commercial enterprises that relate to or operate in domestic or foreign waters. Primary components of the marine industry include vessel operations and vessel support enterprises such as repairmen, supply vendors, and service companies. The following are some terms unique to the marine industry.

Definitions

Prior to October 1, 1991, all sales of boats/vessels were taxed under the Limited Sales, Excise and Use tax statute. Effective October 1, 1991, sales of boats/vessels 65 feet in length or less that are primarily used in a non-commercial manner are subject to the Boat and Boat Motor tax. Effective September 1, 1997, all sales of boats/vessels 65 feet in length or less, regardless of commercial or non-commercial use, are subject to the Boat and Boat Motor tax.

SPECIAL NOTE: The Boat and Boat Motor tax applies to sales only. Rentals and leases of boats/vessels of any size are subject to the Limited Sales, Excise and Use tax.

Bare Rental:

A rental/lease transaction in which possession but not title to tangible personal property is transferred for consideration. The words lease and rental are used interchangeably. Bare rental is the rental of a vessel without a crew.

Broker:

A third party who brings together a company and a customer who desire to transport goods or services for a fee. The broker's fee is not taxable and does not reduce the selling price of the transport service.

Certificate of Documentation:

Refers to Form CG-1270

Commercial Enterprise:

A business entered into for profit. The use of a vessel exploration for or production of minerals is considered a commercial enterprise.

Component Part:

All tangible personal property that is actually attached to and becomes part of vessels in excess of eight tons displacement that are used exclusively for commercial purposes. Includes marine cargo containers and required safety equipment.

Displacement:

The volume or weight of a fluid (such as water) displaced by a floating body (e.g., a ship) of equal weight.

Documented Vessel:

A vessel for which a valid certificate of documentation is outstanding.

Drilling Barge:

A modified barge which contains drilling equipment. Generally not self-propelled and are vessels.

Drill Ship:

A ship which has been modified to facilitate drilling down through the center of the ship. These units are usually self-propelled and are vessels.

Dry Dock:

A dock in which a vessel can lie out of the water while repairs are being made below its waterline. Types of dry docks include:

Floating Dry Dock:

Can be self-propelled or towed from place to place. It looks like a shoebox with the top and ends removed. The bottom and sides contain compartments. Water enters the compartments causing the dock to sink low enough to allow a ship to enter. Pumps then suck the water out and the dock rises, lifting the ship out of the water. **Floating dry docks are vessels.**

Graving or Basin Dock:

Used chiefly to repair large ships and looks like a huge, concrete bathtub sunk into the ground. One end of the dock opens into a waterway. When a ship enters the dock, a floating gate is placed against the open end. Pumps suck the water out and the vessel slowly lowers until its keel comes to rest on wooden blocks placed on the floor of the dock

Railway Dry Dock:

A structure which allows the hoisting of a ship from the water to an elevation above the highest tides, where it rests on a structure fixed to the ground. The railway has a cradle that is lowered into the water along an inclined track until the vessel to be dry-docked can be floated over it. The cradle is then hauled up the track with the vessel until the cradle deck is clear of the water. The cradle then rests on blocks while work is done on the vessel.

Stationary Dry Dock:

Dry dock that cannot be moved.

Travel Lift:

A large forklift type of equipment that can lift a tugboat, shrimp boat, etc., from the water, travel with it and set it down. The travel lift is removed and can be used elsewhere while the work on the vessel is done.

Vertical Lift:

Similar to Railway Dry Dock except that its platform is not supported directly by the ground.

Dunnage:

Loose materials or padding used around cargo to prevent damage or breakage.

Eight Tons Displacement:

The weight of fresh water displaced by a vessel before it is loaded with fuels, supplies or cargo.

Exclusively Used in Interstate Commerce:

Engaged in interstate commerce 100% of the time. Qualification is every quarter.

Fully Found:

The lease, rental or provision of a vessel which includes a crew and generally supplies and materials.

Interstate or Foreign Commerce:

Transporting goods or persons between a point in this state and a point in another state or foreign country. It does not include trips to and from offshore areas or fishing areas on the high seas, or trips between two points in the State of Texas. Verification can be made by reviewing the vessel logs (daily records of the ship's activities).

Jacket:

The primary source of support for offshore stationary non-vessel type drilling or production operations. The legs of the jacket rest on the ocean floor and are anchored with steel pilings driven through each leg into the ocean floor, thus making the jacket a permanent fixture. When set in place, the jacket is considered an improvement to realty. The platform or decking is attached to the jacket, and the rig or production package is placed on top of the platform. This is real property. The rig or production packages are tangible personal property.

Jack-Up Rig:

A barge or floating drilling platform with legs. The legs are lowered to the ocean floor. The platform is then "jacked-up" above the water surface. These rigs may have some self-propulsion but are usually towed to the location. This is still considered to be a vessel.

Licensed and Certificated Carrier:

Documented by the U.S. Coast Guard as a common or contract carrier used to transport persons or property for hire in the regular course of business. A Certificate of Documentation from the U.S. Coast Guard is acceptable documentation of carrier status. A certificate of inspection or seaworthiness is not a form of documentation for carrier status.

Lightering:

Transferring oil or other cargo from a large vessel to a smaller vessel to facilitate delivery to port. After the transfer of a part of its cargo, the larger vessel can enter shallow water ports to discharge the remainder of its cargo.

Marine Cargo Container:

A fully or partially enclosed compartment usually permanent intended for storing goods. (It is strong enough for repeated use. Its special design allows the transport of goods without intermediate loading or unloading.) Includes the accessories and equipment which are part of and are carried with the container. Does not include chassis, vehicles, accessories, or spare parts of vehicles. The marine cargo container is a component part of a vessel.

Ocean Thermal Energy Conversion Facility:

Any facility which is standing or moored in or beyond the territorial sea of the United States and which is designed to use temperature difference in ocean water to produce electricity or another form of energy capable of being used directly to perform work. (Code of Federal Regulations §67-01-1). Vessel status must be documented to qualify for vessel exemptions.

Ocean Thermal Energy Conversion Plant ship:

Any vessel which is designed to use temperature differences in ocean water while floating unmoored or moving through such water to produce electricity or another form of energy capable of being used directly to perform work. (Code of Federal Regulations #67-01-1)

Platform:

The decking which is permanently affixed to the top of a jacket. The rig or production packages are placed on the platform but are not permanently attached to the platform. The platform is considered real property.

Rig:

The use of the word “rig” by the petroleum and drilling industry has a wide variety of meanings, including platform rig, jack-up rig, submersible rig, semi-submersible rig, barge, rig package, derrick, etc. A description of the “rig” in question is necessary before the correct taxing procedures can be implemented.

Rig Package:

Removable modules which may contain power engines, crew living quarters, etc. These are considered tangible personal property.

Semi-Submersible Rig:

A platform (generally used for exploratory drilling operations) which floats on a type of “pontoon” when en route. During drilling operations, the pontoons are submersed to stabilize the rig. These rigs usually require some towing and are considered vessels.

Shifting:

To move vessels from one location to another. Usually one or more tugs assist in the moving.

Ship’s Stores:

Materials and supplies sold to owners or operators of ships or vessels for use and consumption in the operation and maintenance of such ships or vessels.

Texas Territorial Limits:

Includes the first three marine leagues from the Texas coast. This is equivalent to nine nautical miles or 10.357 land miles.

Vessel:

Any craft used or capable of being used as a means of transportation on water. This includes, but is not limited to, ships, barges, shrimp boats, drill ships, jack-up rigs, semi-submersible drilling rigs, dredges, and floating dry-docks.

Information Services

Vessel arrival and departure information is a taxable information service.

Title Histories

A “general index or abstract of title” traces the ownership of a vessel from the construction of the vessel to its current owner. The history lists the location of fabrication, year, builder, and first buyer of the vessel. It uses the official number to track the vessel and lists registered name changes, mortgages, and transfers of title with information pertinent to each transaction. To obtain title histories, contact June Zivley at 512-343-0024 or 800-688-6829.

Ms. Zivley’s department may also have pertinent information in its current files. Inquiries may be made by using the prior or current owner’s name, vessel number, or certificate of documentation number.

Electricity

Port, wharf, and terminal operators may provide electricity and water to vessels moored at their docks. Water is not taxable. Electricity is purchased from the utility company and rebilled to the vessel owner or operator at cost or at a marked-up price. The charge for the electricity is not taxable to the vessel owner or operator. The port, wharf, or terminal operator is providing a nontaxable docking service. They are consuming these utilities in providing the docking service.

If the providing service company is exempt, such as a governmental port or Navigation district, tax is not due on the purchase of the electricity.

If the providing service company is not an exempt entity, tax must be paid on the purchase of the electricity.

Vessel repairmen must pay tax on electricity.

Leased/Contract Employees

Leased Employees:

A company will transfer most or all of its own employees to an employee leasing company. The leasing company pays the employees and withholds and remits the payroll taxes. Usually the leased employees will continue to perform the same work as before and may not even be aware of the transfer except that their pay check has a different name at the top.

Contract Employees:

Are hired by an outside party and contracted out on a contract basis. There may not always be a written contract. If there is a contract, it may specify specific areas of work, or it may just say to “work as directed.”

Temporary Employees:

Perform services that are normally performed by the employers own employees; the employer provides all supplies and equipment necessary; the work is under the direct or general supervision of the employer to whom the help is furnished.

During the entrance conference, ask about leased, contract, and temporary employees. During the field work, examine the financial statements and general ledgers and review the payroll tax accounts. If the payroll tax amounts change materially, ask additional questions. Obtain and review copies of pertinent contracts. If leased and/or contract employees are noted, research the issues thoroughly. Discuss the information with your supervisor to determine how to proceed.

Surveys

Survey documents give specific information of the vessel such as its name, size, and location on the date of the survey. The surveys can be used as an audit tool to complement, complete, or verify information obtained from other sources.

- Condition Survey - A detailed inspection of a vessel to note and record its overall condition. The survey is usually performed at the beginning and end of a lease/charter at a location mutually agreed to by both parties.
- Condition and Valuation Survey - A detailed inspection of a vessel to note and record its overall condition. This survey is used to obtain financing and insurance and used occasionally in lawsuits.
- Damage Survey - Determines the nature and extent of alleged damages. The survey usually includes estimates of repairs from independent repair companies.
- Draft Surveys - Determines the weight of the cargo by displacement before and after loading.

Damage surveys requested by insurance companies, financial institutions or individuals for insurance purposes are taxable effective October 1, 1987.

Fuels

Number two fuel oils and other fuels that are used in diesel engines, gasoline and liquefied gases are covered under the motor fuels tax laws.

Number six bunker fuel, lubricants, motor oils, greases and antifreezes are covered under limited sales, excise and use tax laws. **These items are not component parts of vessels.** But will qualify for sales tax exemption if they are consumed in the operation of a vessel operating exclusively in interstate commerce.

Pre-Audit Research

In addition to standard pre-audit research procedures discussed in the [Auditing Fundamentals Manual](#), determine:

- Types of Customers: transportation companies, leasing companies, drilling industries, shrimp boat operators, vessel repair companies, service companies, etc.
- Types of operations or services provided

Entrance Conference

In addition to standard entrance conference procedures discussed in the [Auditing Fundamentals Manual](#), these areas should be considered:

- Vessel Owners/Operators
 - How many vessels are owned/operated? Obtain a list.
 - How many vessels are leased?
 - Which company contracts with the ultimate customer?
 - Are crews provided with the vessels? If so, who provides the crews?
 - What are the geographical areas of operation?
 - Are exemptions for supplies claimed for vessels engaged exclusively in interstate commerce? For which vessels? For what periods?
 - Where is the home port or dock used to harbor vessels between trips?
 - Where are major repairs performed?
 - Are fishing, diving, gambling or other amusement activities involved?
 - Does the taxpayer repair vessels owned? For others?
 - Number, types and approximate sizes of vessels routinely operated such as inland tugs and barges; ocean-going tugs and barges, ships, drilling vessels
- Repairs
 - Where is the location of repair facilities?
 - What types and sizes of vessels are repaired?
 - What other services are conducted such as vessel cleaning, coatings?
 - What major equipment is used i.e., dry-docks, vertical lifts, loading cranes, forklift?
- Does the taxpayer sell, provide or purchase:
 - Bare Rentals of vessels or other tangible personal property?
 - Diesel fuel?
 - Bunker fuel? Bunker fuel is taxed under sales tax laws.
 - Lubricants, motor oils, greases and antifreezes?
 - Kitchen and/or miscellaneous supplies?
 - Prepared food?
 - Catering services?
 - Laundry services?
 - Guard services?
 - Storage or warehouse services?
 - Information services?
 - Waste disposal services?
 - Real property repairs or remodeling?
 - Fabrication, repair, remodeling, or maintenance of tangible personal property?
 - Fishing supplies?
 - Fabrication, repair, or remodeling of motor vehicles such as trailers?

Tour of Premises

Visit the boat yard, repair areas, home port, storage area or applicable areas used by the taxpayer in this business. Go aboard a vessel(s) if possible. Have the taxpayer identify and describe the functions of major equipment.

Internal Controls

Many vessel-related companies code sales and purchases to individual vessels. Small companies may not do so. Internal controls should be tested and verified using standard procedures discussed in the [Auditing Fundamentals Manual](#).

Tax Reports

Gross sales must include:

- All services
- All rentals and leases
- All sales including sales of assets

Deductions should include:

- Non-taxable services
- Tax-free sales, rentals and services supported by valid resale, exemption or direct pay certificates
- Sales tax charged, if included in the gross sales reported.

Taxable purchases should include:

- Items purchased tax free on which tax is due.

Standard audit procedures should be used to audit gross sales and tax collected. See Chapter 5 in [Auditing Fundamentals Manual](#).

Statute: 151.406

Rule: 3.335

Unless noted otherwise, all discussions pertain to vessels of eight tons or more displacement and which are used exclusively in a commercial enterprise.

Chapter 2

- Sales and Deductions
 - Records To Be Examined
 - Certificates
 - Audit Procedures for Sales Transactions
- Certification of Documentation
- Purchases
 - Audit Procedures for Purchases
- Component Parts
- Shrimp Boats and Fishing Boats
- Shipyards/Vessel Repairmen

Sales and Deductions

Records To Be Examined

- Chart of accounts
- Federal income tax returns
- Financial statements
- General ledgers
- Sales ledgers
- Sales invoices
- Sales contracts with customers
- Job files
- Work orders
- Lease/rental contracts with customers and applicable lease amendments and extensions.
- Service contracts
- Asset register or depreciation schedules. Note deletions and additions during the audit period.
- Certificate files
- Vessel logs

Certificates

Although exemptions are available for vessels, the owner or operator of a vessel must give the vendor an exemption certificate to document each exemption claimed. These certificates do not necessarily substitute for each other as the exemptions are different. For example: A certificate claiming an exemption for component parts is not valid for sales of lube oils. But a certificate claiming an exemption for a vessel operating exclusively in foreign or interstate commerce is valid for component parts and ship's stores. A common problem is that vendors may not be able to obtain a certificate after the fact. The vessel may be a foreign or non-Texas vessel that stops in Texas infrequently and the corporate offices may be difficult to locate.

Audit Procedures for Sales Transactions

Vessel companies may have a wide variation of types of transactions, exemptions claimed by customers, and dollar amounts on invoices.

The marine industry does not readily lend itself to basic sampling techniques. Many of these audits must be detailed.

- Examine the general ledger, financial statements, federal income tax returns, other ledgers and records for material and/or unusual transactions.
- Determine if vessel rentals to customers are bare rentals, vessels used in repair, remodeling or restoration of real property, vessels used to repair, remodel or maintain tangible personal property, services, etc.
- Verify that sales and services discussed during the entrance conference were handled correctly including:
 - Diesel Fuel - audit if necessary.
 - Guard services both aboard the vessel and dockside may be taxable for all vessels regardless of size. Interstate commerce exemptions do not apply. Taxable effective October 1, 1987.
 - Armored carrier delivery of payrolls. Taxable effective October 1, 1987. Interstate exemptions do not apply.
 - Movie/video sales and rentals - interstate commerce exemptions do not apply.
 - Food sales - to employees, service crews and visitors aboard may be taxable.
 - Amusement services such as gambling, fishing, diving.
- Checklist for sales. Was the:
 - Sale covered by a resale, exemption or direct payment certificate? Not taxable.
 - Tangible personal property delivered out of state by the vendor? Not taxable. Examine sales or lease contracts, invoices, logs, surveys, delivery tickets.
 - Vessel sold, rented, or leased by the builder? The vessel may be new or used. Evidence of the facts of building can be found on U.S. coast guard builder's certificate CG-1261. Other documentation containing the same information may be used. Otherwise, examine building plans, contracts, and other information.
 - Sale an identifiable segment or the entire operating assets of business? Not taxable. Even if no sales were made by an entity that owns vessels, document in the audit plan whether a sale of vessels by that entity would qualify as the sale of an identifiable segment. Then, should a sale be made, the auditor of a purchaser can verify documentation provided by the purchaser.
 - Tax charged on sales of lubricants, motor oils, greases, antifreezes, rig wash, solvents, and other chemicals unless a valid certificate was on file?
 - Transaction a sale of repossessed property by a financial institution? (Repossessions in the hands of financial institutions are considered to be the sale of inventory and does not qualify as an occasional sale.) Taxable.
 - Vessel seized and title transferred by the U. S. Marshal under a court order? If the purchaser does not pay the mortgage payments, and a resolution satisfactory to both the mortgaging company and the purchaser cannot be reached, the mortgaging company notifies the U.S. Marshal to arrest and seize the vessel in question. The marshal takes possession of the vessel and provides necessary security while in the marshal's possession. If the court then orders the vessel sold, the U.S. Marshal conducts the sale, collects the money, and remits the sales amount less applicable expenses to the mortgaging company. The marshal causes the title to transfer. The U.S. Marshal is an arm of the federal government. The comptroller cannot force the federal government to collect and remit the tax, so the sale is not to be set up on the seller. We can proceed against the purchaser for the tax that should have been collected and remitted.
 - Sale made to an individual seaman? Taxable even though the vessels may be operating exclusively in foreign or interstate coastwise commerce.

Statute: 151.304, 151.329

Rules: 3.297, 3.316

Certification Of Documentation

This section revised 02/27/01

Effective August 12, 1998, Rule 3.297 was amended to no longer exempt from use tax tangible personal property that is acquired outside this state and brought into Texas for use in the regular course of business of transporting persons or property by a licensed and certificated carrier as defined in Rule 3.297(a)(1). After the rule change in 1998, vessels have to meet the criteria outlined in Rule 3.297(b)(1) to be exempt from use tax. However, a licensed and certificated carrier, as defined in Rule 3.297(a)(1), does not owe use tax on tangible personal property that was acquired outside this state and brought into Texas before August 12, 1998, for use in the regular course of business of transporting persons or property.

A certificate of documentation refers to form CG-1270 and is required for certain vessels in certain trades as evidence of the vessel's nationality. A vessel may be endorsed for more than one trade including registry, fisheries, great lakes, or coastwise trade. In some cases, it permits the vessels to be subject to preferred mortgages.

- Coastwise Trade: Includes the transportation of passengers or merchandise between points in the United States embraced within the coastwise laws.
- Fisheries: Includes processing, storing, transporting (except in foreign commerce), planting, cultivating, catching, taking, or harvesting fish, shell fish, marine animals, pearls, shells, or marine vegetation in the navigable waters of the United States or in the exclusive economic zone.
- Registry: A vessel employed in foreign trade; trade with Guam, American Samoa, Wake, Midway, or Kingman Reef; and in other employments for which a coastwise, great lakes, or fishery license is not required.

A certificate is valid for one year. Upon expiration, the owner must apply for a renewal. The renewal information is found on the back of the certificate. A certificate is invalid and subject to summer for many reasons including but not limited to the following:

- ownership changes in whole or in part.
- changes in the general partners of a partnership
- change in the home port
- change in gross or net tonnages or dimensions of the vessel
- changes in legal name of any owner
- changes by addition, deletion, or substitution of trade endorsements
- substantial error corrections

Purchasers must reapply for a certificate and cannot use the seller's document. Only owners can obtain certificates of documentation but the effects of the certificates pass to the lessee for use tax exemptions.

A safety inspection certification does not qualify as a certificate of documentation because it certifies the seaworthiness of the vessel.

Statute: 151.330

Rule: 3.297

Unless noted otherwise, all discussions pertain to vessels of eight tons or more displacement and which are used exclusively in a commercial enterprise.

Purchases

Records To Be Examined

- Chart of accounts
- General ledgers
- Federal income tax return
- Financial statements
- Purchase/Accounts Payable Ledgers
- Purchase invoices
- Contracts with vendors
- Lease/rental contracts with vendors. Be sure that lease amendments and extensions are also included.
- Certificates of documentation
- Sales invoices to customer (see "[Services, Rentals and Leases Section](#)")
- Asset files or depreciation schedules
- Vessel logs

Audit Procedures for Purchases

The following procedures should be performed in conjunction with the standard procedures discussed in Chapter 5 of the [Auditing Fundamentals Manual](#).

- Scan the general ledgers, financial statements, federal income tax returns and other records for material and/or unusual transactions with particular attention to equipment lease or rental accounts.
- Examine the records for purchases of tangible personal property or services.
- Examine lease contracts of vessels and/or equipment. See "[Services, Rentals and Leases.](#)"
- If tax was paid on exempt items, explain refund procedures or give credit if tax was paid directly to the state.

The following is a partial list of items not subject to the limited sales or use tax:

- Purchase of an identifiable segment of a business
- Purchase of the entire operating assets of a business
- Purchase of tangible personal property which qualified as an occasional sale for the seller. The most common exemptions under the occasional sale rule are for sales of identifiable segments and sales of the entire operating assets of an entity. Effective 09-01-93, a person holding a sales or use tax permit will be required to accrue and pay use tax on a purchase that otherwise would qualify as an occasional sale under section 151.304(b)(1).
Note: the occasional sale exemption does not apply to a boat that may displace 8 tons of fresh water, used exclusively in a commercial enterprise, but is 65 foot or less and therefore subject to the Boat and Boat Motor Sales Tax.
- Purchases of vessels repossessed by financial institutions do not qualify as occasional sales. These vessels are considered to be inventory in the hands of the financial institution. If the U. S. Marshal sells the vessel under a court order, the purchaser owes taxes on the sale if possession was taken in Texas and the purchaser could not have given a valid resale, exemption, or direct pay certificate. For additional discussion of the U. S. Marshal transactions, see information in the [sales and deductions section](#).
- Items purchased out of state, temporarily stored in Texas, but subsequently remodeled and used solely outside Texas.
- Items purchased out of state and used outside Texas for more than one year before the date of entry into Texas.
- Vessels acquired outside this state and moved into this state for use as certificated carriers. If possession of the vessel is taken out of state and the vessel has a valid certificate of documentation at the time of the acquisition, use tax is not due. For fixed-term leases, the vessel must qualify for this exemption for each lease term. Vessel logs may provide documentation that possession was taken out of state. (Also see "[Services, Rentals and Leases Section.](#)")
- New or used vessels purchased or leased from the builder.
- Component parts are not taxable no matter where affixed. (Also See Component Parts Section)
- Marine cargo containers
- Materials, supplies, and equipment, including ship's stores and sea stores sold to owners or operators of ships or vessels operating exclusively in foreign or interstate commerce or for use and consumption in the operation and maintenance of such ships or vessels.
- Materials, supplies, and labor used in repairing, renovating, or converting a ship or vessel. This does not include equipment used in the repair which does not become a component part of the vessel. However, certain repair supplies and parts may qualify for exemption without actually becoming a component part.

Non-taxable items would include:

- Nitrogen - used to gas-free vessels or for other safety reasons
- Oxygen and gases - used in welding
- Degreasers and cleaners - used to prepare surfaces for coating or painting
- Sand - used for sandblasting
- Paints, coatings, and thinners

Taxable Items Would Include:

- Equipment and accessories including the repairs and placement parts
- Masks, gloves, safety glasses,
- Hand tools
- Electricity

Statute: 151.304, 151.317, 151.318, 151.3219, 151.330

Rules: 3.192, 3.194, 3.295, 3.297, 3.300, 3.316, 3.346

Component Parts

Component parts of vessels are not taxable no matter where affixed. Component parts may vary according to the type of vessel and its use.

Component parts common to all vessels include:

- Aluminum skiffs
- Appliances bolted or firmly attached to the vessel
- Bumper/bumper tires
- Fire extinguishers, safety or personnel nets
- Intercoms
- Leased equipment can become a component part if affixed
- Life boats and life preservers
- Light bulbs - general use; cabins, etc.
- Light bulbs/filaments - used in spotlights
- Radio and radar equipment - attached
- Ropes, chains, tongs, elevators, swivel wire rope
- Sandlines, weight indicator gauges
- Swing gauges

Items which are component parts of drilling vessels include:

- Bits, drill pipe
- Swivels
- Sand line
- Weight indicator gauge
- Bushings, collars
- Safety or personnel net
- Cementing, logging, mud monitor logging, and power units
- Drawworks
- Derrick, masts, hoisting equipment attached to the rig and mud pumps
- Slips, liners, elevators, tongs, swivels, kelleys. Adaptors,
- Blowout preventers (exempt unless at the well site)
- Rotary hose,
- Automatic driller

Items which are not considered to be component parts include:

- Bedding and linens
- Casing
- Clothing
- First aid kits
- Food
- Flare gun kits
- Fuel
- Furniture and appliances that are not attached
- Hand tools and consumables
- Kitchen items such as pots and fans
- Lanterns - mobile or hand held
- Pipes, pumps, and pontoons used by dredges
- Radios, telephones, and pagers - mobile or hand held
- Safety belts
- Tableware and linens
- Wash pipe packing

Shrimp Boats and Fishing Boats

Are not exclusively engaged in interstate commerce and are not exempt for materials and supplies.

Component parts may include:

- Fire extinguishers, safety or personnel nets
- Fishing nets - including twine to repair the nets
- Intercoms
- Life boats and life preservers
- Long line fishing gear includes monofilament used for the mainline, float lines, marker buoy/fish float lines, and fishing lines (lines that hold the hooks); big game hooks; lead swivel or bank sinker; snaps; marker buoys or fish floats, floats; and the radar reflector, battery, and strobe lights that are mounted on a pole to mark the beginning, intermediate, and ending points of the long-line fishing gear. These items are assembled into one unit called the long-line fishing gear.
- Radio, radar, and other communications equipment that is affixed to the vessel.
- Rented or leased equipment that is affixed to the vessel
- Rigging equipment - including turnbuckles, shackles, thimbles, and eye swivels, wire, chains

Non-taxable items that are not component parts include:

- Ice

Taxable items that are not component parts include:

- Appliances - unattached
- Clothing - including protective wear such as raincoats and helmets
- Consumables - including paper and plastic products, soaps, and cleaners
- Food - including candy, sodas and beer
- First aid kit
- Flare gun kit
- Flashlights
- Lubricants - including lube oils, antifreezes, and freons
- Portable equipment - including radios, telephones, and lights
- Rigging that is not attached to the vessel
- Safety belts
- Shrimp dip (monosodium metabisulphite - chemical powder to keep shrimp from spoilage)
- Tableware, mattresses, and linens
- Tools - including ice shovel, meat hooks, bolt cutters, and wrenches.

Statute: 151.329

Rules: 3.297, 3.320

Fiche: 433.E01, 630A04, 934A09, 1197D11

Shipyards/Vessel Repairmen

A shipyard or repair facility may perform many functions or services including but not limited to:

- Docking, mooring, and fleeting services - Not Taxable
- Lifting and storing vessels - Not Taxable
- Fabricating new vessels - Not Taxable
- Repairing or remodeling vessels - Not Taxable
- Selling fuels, lube oil, greases, etc.
- Leasing vessels with or without operators. Must tugboats or pushboats are leased with operators
- Fabricating, remodeling, repairing, or maintaining miscellaneous items including oil field equipment, heavy equipment, and trailers (motor vehicles), miscellaneous welding is quite common.

- Building, repairing, or remodeling real property
- Furnishing warehouse or other storage facilities

Sales

Review the sales and deductions section of this manual.

Sales transaction must be reviewed and audited. The examination of the sales transactions is the basis for determining the taxability of purchases.

It is usually difficult to utilize sampling procedures in the examination of marine sales transactions because of the wide variety of work that may be performed, the large variations in amounts, and the complexity of the exemptions that may be available. These procedures should be considered:

- During the entrance conference and field work, discuss with taxpayer representatives to determine all the types of work that was performed during the audit period. Review financial statements, general ledgers, and other information during the preliminary work to help to identify these areas.
- Determine if work order files are maintained. Will they be helpful?
- Read the vessel repair invoices and learn to understand them. Note if lube oils, antifreezes, and other non-component parts are being billed separately.
- After the system and information has been reviewed and is understood, decide how to audit the sales.
- Determine how to distinguish between charges for bare rental, and charges for equipment with operators or used as part of a service. For example, a barge may be a bare rental. A barge may be provided along with a tug to move people or products from point A to point B. A barge may be taken to a repair site and left there to use as a work station while the taxpayer is performing work. Invoices may not be clear and additional questions and information may be needed.

Purchases

Review the purchases section of this manual.

- Determine the taxability of the purchases for each type of transaction identified in the examination of sales.
- Determine if purchases can be identified with the work performed. For example, can the purchases used for vessel work be identified? Can purchases for non-marine work be identified? The repairman must pay tax on equipment and non-exempt purchases even though the vessel is owned by a governmental agency. (For example, refurbishing vessels for the federal government during the Desert Storm period.)

Lump Sum Contracts

Under a lump sum contract, the repairman is considered to be the consumer of the goods purchased for use in the repair. Generally, the lump sum contractor/repairman has to pay tax on the materials. However, sec. 151.329(3) allows a specific exemption for materials used in the repair of a vessel of eight tons or more displacement which is used exclusively in a commercial enterprise. Therefore, the repairman should issue an exemption certificate in lieu of paying tax on these purchases.

Statute: 151.329 151.330

Rule: 3.292

Unless noted otherwise, all discussions pertain to vessels of eight tons or more displacement and which are used exclusively in a commercial enterprise.

Chapter 3

- Services, Rentals and Leases
- Bare Rentals/Lease Versus Service
- Vessels Used in Interstate Commerce
- Related Services Companies
 - Stevedores
 - Steamship Agency Services
 - Terminals, Ports, and Wharfs
 - Drilling Vessels and Offshore Exemptions

Services, Rentals and Leases

If the party providing the vessel also provides the crew, a service has occurred. The service is taxable or non-taxable depending on the activities performed. Sometimes barges have “non-operating” employees assigned to facilitate loading and unloading. This is not considered providing a crew, with the barge.

The following is a partial list of taxable and non-taxable services:

- Transport of persons, property or products by a third-party. **Non-taxable if billed by the third party.**
- Delivery of a bare rental by the lessor. **Taxable.**
- Pick-up or return of a bare rental by lessor. **Taxable.**
- Delivery, pick-up, or return of a bare rental by a third party. **Non-taxable if billed by the third party.**
- Repair, remodeling, or restoration of non-residential real property. **Taxable** effective January 1, 1988.
 - Waterfront property repairs such as docks and wharfs.
 - Platform repairs in Texas waters
 - Pipeline repairs in Texas waters
- Repair, remodeling, and maintenance of tangible personal property. **Taxable.**
- Repair of oil field equipment in Texas waters or marshlands. **Taxable.**
- Taxable oil field services when the well site is in Texas waters are treated when whose services are performed on land. The charge for the vessel is part of the taxable service if included in the billing by the service provider.

When examining rental and lease transactions, review rule 3.294 and related fiche and documentation. The following procedures should be followed:

Determine if the lease is a bare rental or a service. If it is a bare rental, then follow these procedures:

- A financing lease is treated as a sale, and tax is due on the transaction at the inception of the lease if possession is taken in Texas.
- An operating lease treatment depends of the length of the lease.
 - Fixed Term
 - If the customer takes possession in Texas, sales tax is due on the full/lease price.
 - If the vessel is acquired out of state and is brought into Texas for use, use tax is due unless the vessel has a valid certificate of documentation at the effective date of the lease.

The effective date of each lease is important. The effective date of the lease can be determined by reading each lease, addendums, etc. The effective date may be stated in the documents or it may be contingent upon some other event such as the completion of repairs, survey and acceptance by the lessee, or possession. The effective date applies to the original lease and to each addendum, extension, change, or additional lease periods.

A change in price not addressed in the lease or that is not caused by factors independent to both parties constitutes a new lease. Each price change must be examined on its own.

◦ Period to period

Sales tax is due on the full rental price for any day or part of a day during the rental period that the vessel is in Texas. These leases usually are for periods not covered by formal leases, addendums, extensions, etc., or for day-to-day leases. Include the total monthly lease payments in an audit schedule unless documentation is provided for days in and days out of Texas. It is suggested that rentals be listed on an exam separate from other transactions if these are numerous or material.

If it is a service:

- Determine if the service is taxable. The rental or lease of a vessel for towing services or charter hire to move cargo from point A to point B are not taxable. These rentals are usually rented “fully found” or fully “crewed” and are considered to be rentals with an operator performing non-taxable services. Review the services section above to a partial list of taxable transactions
- Obtain lease agreements including all amendments and extensions.
- Examine cash receipts, ledgers, and income accounts for lease receipts.
- Examine cash disbursements and ledgers for lease payments.
- Examine lease agreements and all amendments, extensions, and changes with special attention to these areas:
 - Lessor Name
 - Lessee Name
 - Vessel Name(s): A vessel’s name may be changed at the owner’s discretion.
- Lease price. Note agreements on future price changes. Price change notifications may be made by letter or other method.
- Location of possession on the effective date of each lease term.
- Lease extension/renewal information
- End of lease date or cancellation date. Renewals and cancellations may be made by letter or other form.
- Location of return of vessel to lessor.
- Lease term - determine the original lease term, each new lease term caused by amendments and each lease extension. Distinguish between fixed-term, period-to-period and day-to-day leases.

Note: A schedule of this information can be made to use during the sales and/or purchases of the audit section.

Examples of Lease Terms:

Example 1: One-year lease beginning January 1, 1990, was amended effective March 1, 1990, to extend the end of the lease to June 30, 1991.

Original Lease Term of January 1, 1990 through December 31, 1990 is one lease.

Amended Lease Term is March 1, 1990 through June 30, 1991 and is a separate lease.

Example 2: One-year lease beginning January 1, 1990 with 30-day extensions.

Original Lease Term is January 1, 1990 through December 31, 1990.

Each 30-day extension is a separate lease.

Original Lease Term is January 1, 1990 through December 31, 1990.

January 1, 1991 through January 30, 1991 is a lease.

January 31, 1991 through March 1, 1991 is a lease, etc.

The effective date of each lease is important. The effective date of the lease can be determined by reading the lease, addendums, etc. The effective date may be stated in the documents or it may be contingent upon some other event such as completion of repairs, survey and acceptance by lessee, or possession. The effective date applies to the original lease and to each addendum, extension, or additional lease periods.

Audit Procedures for lessors of bare rentals:

For each vessel:

- Determine all lease terms involved.
- Determine location of vessel on the effective date of each lease term to identify location of lessee possession.
 - Possession in Texas - entire lease term is taxable.
 - Possession outside Texas - not taxable
- For taxable leases, determine the lease price(s) during the lease.

Audit Procedures for lessees of bare rentals:

For each vessel:

- Determine all lease terms involved.
- Determine location of vessel on the effective date of each lease term to identify location of lessee possession.
 - Possession in Texas - entire lease term is taxable
 - Possession outside Texas
 - Vessel had a certificate of documentation during lease term - not taxable.
 - Vessel with no certificate brought into Texas during lease term - entire lease term is taxable
 - Determine lease price(s) during the lease term.

Bare Rentals/Leases Versus Service

Some types of lease transactions are difficult to identify. It is common in the marine transportation industry for a tug with crew (operating company) to use barges belonging to others to transport cargo for its customers. A percentage of the amount invoiced by the tug operator to its customer is allocated to the barge owner in a 70/30 or 60/40 split with the larger percentage going to the tug operator. The use of these barges in this situation can be a bare rental. The rental value is the amount allocated to the barge owner(s) by the tug operators.

Operating Company Procedures

- Sales - Use standard auditing procedures
- Purchases
 - Identify vessels owned by operating company.
 - Identify vessels leased to the operating company via leases.
 - Identify vessels operated by the operating company.
 - For each vessel determine if a crew was provided, and who provided the crew. Workers may be assigned to barges to assist in loading or unloading, etc., but barges are not considered to be “vessels with crews.”
 - Read the sales invoices from the operating company to its customers and identify the vessels involved. Determine the provider of each vessel and then determine if a bare rental has occurred between the operating company and the provider of the vessels. Any adjustments would be made on a purchases exam but should reference the sales invoice for an audit trail.

Examples:

A = Tug Owner

B = Barge Owner

C = Customer who contracts for the Transportation of Goods.

D = Crew Provider.

Example 1: A contracts with and bills C. A uses A's tug and crew and B's barges.

A is providing a non-taxable service for C. A owes tax on the amount allocated to B for the bare rental of the barge. A is the operating company.

Example 2: A contracts with and bills C. A uses A's tug, crew and barges. A is providing a non-taxable service for C. No tax liability is incurred for either party. A is the operating company.

Example 3: D contracts with and bills C. D uses A's tug, D's crew and B's barges. D is providing a non-taxable service for C. D owes tax on the rental of A's tug and B's barges. Rental value is the amount allocated to each by D. D is the operating company.

Example 4: A contracts with and bills C. A uses A's tug and crew to push C's barges from one location to another. A is providing a non-taxable service for C. No tax liability is incurred for either party. A is the operating company.

Example 5: The information is the same as Example 1 except that "A" pays a broker a commission of 5% of the amount invoiced to C.

The commission is a non-taxable expense to A. The commission does not reduce the taxable rental value of the barges. A is the operating company.

Unless noted otherwise, all discussions pertain to vessels of eight tons or more displacement and are used exclusively in a commercial enterprise.

Vessels Used in Interstate Commerce

Materials and supplies, including items commonly known as ships' stores and sea stores, sold to owners or operators of vessels operating exclusively in foreign and interstate commerce for use and consumption in the operation and maintenance of such ships or vessels, are exempt from the sales and use tax. These are usually defined as follows:

- Sea Stores - Necessary for the sustenance and maintenance of the vessel's passengers and crew during the voyage.
- Ship's Stores - Necessary for the maintenance of the ship during its voyage.
- Ship's Equipment - Necessary for the navigation or operation of the vessels or for the accommodation of the cargo and passengers aboard.

Procedures and Purchases

- Read definition of "[Exclusively used in foreign or interstate commerce.](#)"
- Ask taxpayer which vessels are operating exclusively in foreign or interstate commerce.
- Read ship's logs to determine if exemption applies. Each vessel must qualify separately by calendar quarter.
- Purchases which qualify for the exemption include but are not limited to:
 - Lubricants, greases, Antifreezes
 - Kitchen supplies and cleaners
 - Furniture, unattached
 - Hand tools and consumables
 - Tableware and linens
- Movie and video rentals are not exempt.
- Shore services while in port are not exempt. Owners or operators of vessels in ports, on standby, or in storage, including those exclusively engaged in interstate commerce, cannot claim an exemption for shore services unless the owner or operator is an exempt entity such as the federal government, Coast Guard, etc., and the sales of taxable items or services are actually sold to the exempt entity. Providers of non-taxable services such as mooring and fleeting must pay tax on purchases even though their customer is an exempt entity. Taxable shore services include but are not limited to:
 - Amusement services
 - Armored car services
 - Damage surveys
 - Garbage and trash disposal services
 - Information services
 - Insurance services
 - Janitorial and custodial services
 - Laundry and dry-cleaning services

- Motor vehicle parking and storage services
- Security services
- Telecommunications services
- Utility chargers for natural gas and electricity are not taxable unless sold directly to the vessel by the utility company.
- Water is not taxable

Statute: 151.0048, 151.0101, 151.329

Rule: 3.297, 3.320

Related Service Companies

Stevedores

Stevedores primarily load and unload ships or other vessels. Cargo may be individual items such as automobiles which are loaded by driving them on and off the vessels. Cargo may come prepackaged in containers, bundled such as wood products, or palletized. Some may be in bags such as flour, or in barrels containing small items. These cargos may be loaded individually by workers if not palletized or may be temporarily loaded onto pallets at one location, transported, and then taken off the pallets at the second location. Cargo may be loose cargoes such as grains. These cargos are loaded by pumps or blowers. Stevedores are rarely involved with liquid cargoes such as crudes or, sulphurs.

In order to load, separate, and stabilize the cargo, packing materials are needed. For example, one type of grain may be loaded into the ship's hold, then a layer of paper is laid and attached to the sides with clips, shackles, turnbuckles, etc., to hold it in place. A second layer of a different grain is then loaded. Several types of loose grains may be in one hold at the same time. Barrels are stabilized by placing plywood and timbers around them. Wood products are used to stabilize most cargo to keep it from shifting during transit.

As a general rule, the stevedoring company contracts to provide the labor and materials for its services and provides the shipping company a detailed invoice for labor, overtime, timbers, paper, etc.

The stevedoring company utilizes different types of equipment in their services, but the primary equipment used are forklifts, pallets, and cranes. The shore cranes may be used or mobile cranes may be used. The crane may be owned by the stevedoring company or may be rented with billings that are lump sum (service) or separated (bare rental and the provision of an operator). Forklifts and pallets may be owned or rented.

Stevedores must pay tax on all equipment and services even though the vessel may be exclusively engaged in interstate commerce. The stevedores themselves are not engaged in interstate commerce.

Stevedores may purchase packing materials tax-free if used on vessels engaged in interstate commerce.

Steamship Agency Services

A steamship agency service company is not synonymous with an "agent" unless the vessel owner or operator has signed a contract with the service company which empowers them to act for the owner or operator. If the service company is a bona fide "agent" of the owner or operator, purchases of goods and services by the service company are treated the same as those purchased by the vessel owner or operator.

Steamship agencies may provide a variety of services for vessel owners and operators. These services may include but are not limited to:

- Arranging for a pilot to bring the vessel into and out of port
- Arranging for tugs to dock and undock the vessel
- Arranging for fuel deliveries
- Arranging for supply purchases such as food and paper products
- Arranging for vessel repairs, parts, and materials
- Arranging for dock services such as utilities, guards, waste disposal, and security services.

When the steamship agency company makes the arrangements for the acquisition of the services or products, and the vendor will invoice the vessel directly, the vessel owner or operator must:

- Pay tax to the vendor
- Give the vendor an interstate commerce exemption certificate, if applicable, or
- Give the vendor an exemption certificate for component parts, repairs, etc., if applicable.

Other times, the vendor will bill the steamship agency company directly to assure payment and the steamship agency company will bill the vessel. For these transactions, the steamship agency company is the customer of the vendor and cannot give the vendor any type of exemption certificate unless the company is a bona fide “agent”. In this situation, the exemption certificate must state that the company is the official agent of the vessel. Otherwise, the steamship agency company may give the vendor a resale certificate and:

- Collect tax on taxable items and services
- Obtain a valid interstate commerce exemption certificate from the vessel, if applicable, or
- Obtain a valid exemption certificate for component parts, repairs, etc.

Terminals, Ports, and Wharfs

A terminal is defined as a storage area along the wharf, dock, or port.

Terminal operators primarily load and unload cargo from rail facilities, trucks, etc., and put into or take out of storage. They are the custodian of the cargo and are responsible for keeping up with what is stored and where it is stored. The stevedores primarily load and unload cargo between the lane facilities and the vessels themselves.

Terminals provide physical space for vessels to dock and usually provide storage for cargo both indoors and outside. A terminal may be:

- Public terminals owned by a governmental entity such as a navigational or port district and is available to the public.
- Public terminals owned by a commercial entity and available to the public.
- Private terminals may be by marine operating entities and available to vessels owned, operated, or contracted by that entity.

The terminal facilities usually have a shore crane with an operator to onload and offload cargo. It may have bonded warehouses, unbonded warehouses, or open dock space to store cargo. It may have office space for rent to stevedoring companies or others who are at the port on a short term basis.

Terminals may provide utilities such as shore power (electricity) and water and may sell lubricants, refrigerants, and fuels. Terminal operators may also make bare_rentals of equipment such as pallets and welders. Pallet rentals invoices may use the term “usage charge” rather than “rental” and the fee may be computed based on the number of tons moved rather than the specific number of pallets used.

Vessels may tie up at locations other than terminals or docks. They may tie up at such places as the side of a river or waterway. Loading and unloading these vessels requires that mobile equipment be transported to the site.

Drilling Vessels and Offshore Exemptions

Transactions may be exempt under statute 151.329 vessel exemptions or statute 151.324 equipment used elsewhere for mineral exploration or production. See the discussion on offshore transactions in well servicing companies booklet.