DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 04-0373
Sales and Use Tax
For Tax Years 2004

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ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-5-8; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. Also, the same individual signed the rental agreement as both lessor and lessee. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer states that it qualifies for the rental exemption found in IC 6-2.5-5-8(b), which states:

> Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

Taxpayer states that the Department has provided no evidence that it has statutory or regulatory authority to require arm's-length pricing. Taxpayer also states that it consulted an aircraft consultant who agreed with its rental rate. Taxpayer states that the Department can not invalidate a business restructuring due to the presence of a tax benefit. Taxpayer also states that, in the event the Department finds that it does have authority to impose arm's-length pricing in rental rates, the only remedy is to modify the rates and not to invalidate the claim for exemption. Taxpayer has provided no documentation in support of its position.

Taxpayer is incorrect on all counts. The rental exemption provided in IC 6-2.5-5-8(b) plainly states that the person claiming the exemption must resell, rent or lease the property in the ordinary course of its business. From all evidence available to the Department, taxpayer is not in the business of renting aircraft. Taxpayer has provided no documentation of any business activity at all, beyond the lease agreement signed as lessor and lessee by the same individual, let alone sufficient documentation to establish that it rented the aircraft in its ordinary course of business. Taxpayer has not even provided documentation that any rental payments were made at its generously low rental rate. Taxpayer has not provided any documentation that the rental rate is common or even in on the low end of going market rates.

Regarding taxpayer's claim that there is no authority for the Department to impose arm's-length pricing for the rental rates, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for

the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

Finally, taxpayer's claims that the Department can not invalidate a business restructuring due to a tax benefit and that the only remedy is to modify the rental rate are evidence that taxpayer fundamentally misunderstands the Department's actions. The Department is not invalidating a business restructuring. It simply determined that a taxpayer was not eligible for a claimed exemption. There is no need to modify a rental rate here. Taxpayer claimed an exemption for which it was not eligible and the Department disallowed the exemption. A sale occurred and sales tax was due but not paid. It's that simple.

In conclusion, the Department denied taxpayer's claim for exemption because taxpayer did not qualify for the exemption provided in IC 6-2.5-5-8(b). The Department was not attempting to invalidate taxpayer's business restructuring, but was merely denying an invalid claim for exemption. All evidence available to the Department shows that this was a "sham transaction" and the Department was correct to deny the claim for exemption.

FINDING

Taxpayer's protest is denied.

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