**DEPARTMENT OF STATE REVENUE**

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**Letter of Findings Number: 06-0174**
**Sales and Use Tax**
**Tax Period: 2003**

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## ISSUES

**I. Sales and Use Tax – Imposition/Aircraft Purchase**

**Authority:** IC 6-2.5-2-1, IC 6-2.5-3-2(a), IC 6-2.5-2(c)(1), IC 6-6-6.5-8(d), IC 6-2.5-5-8, IC 6-8.1-5-1(b); 45 IAC 2.2-5-15(c)(1); *Indiana Dept. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003).

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

## STATEMENT OF FACTS

Guarantor formed a limited liability company ("LLC") for the express purpose of purchasing an airplane. The transaction took place in January 2003 for the price of $77,000. The guarantor, being the sole member of the LLC at the time, signed an "Operating Agreement" in October 2003. Taxpayer did not pay sales tax on the purchase of the aircraft then (or, for that matter, to this date), because pursuant to the Operating Agreement, taxpayer claimed to be in the business of renting and leasing the aircraft in the ordinary course of its business. Taxpayer did file a retail merchant certificate in October of 2002. Taxpayer filed a Form 7695 and claimed a sales and use tax exemption for rental or lease to others.

Taxpayer claims that it posted an advertisement to join the LLC as members of a "flying club" on a bulletin board in the fixed based operations at Greenwood Aviation. Two individuals saw the advertisement and subsequently signed the operating agreement, which required the two new members to pay a lump-sum fee for a buy-in share of a "membership unit" in the airplane. Monthly fees were also required of the two individuals, in addition to an hourly rate for the use the aircraft.

The Department sought documentation to substantiate the rental and leasing exemption. The documentation provided did not adequately substantiate that Taxpayer was renting and leasing, so Taxpayer was assessed use tax due on the purchase of the aircraft.

**I. Sales and Use Tax – Imposition/Aircraft Purchase**

## DISCUSSION

It is taxpayer's position that it qualifies for a sales and use tax exemption on the purchase of its aircraft because it claims to be in the business of renting or leasing. Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC 6-2.5-2-1. Indiana imposes a complementary excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana. IC 6-2.5-3-2(a). Payment of sales tax at the time of purchase exempts the use of tangible personal property from the use tax. IC 6-2.5-2(c)(1).

IC 6-6-6.5-8(d) provides for the payment of sales or use tax on an airplane as follows:

A person shall pay the gross retail tax or use tax to the department on the earlier of:

(1) The time the aircraft is registered; or

(2) not later than thirty-one (31) days after the purchase date;

unless the person presents proof to the department that the gross retail tax or use tax has already been paid with respect to the purchase of the aircraft as proof that the taxes are inapplicable because of an exemption.

Taxpayer bases its claim for exemption on the following provisions of IC 6-2.5-5-8, which states as follows:

Transactions involving tangible personal property 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 his business without changing the form of the property....

The Compliance Division–Aeronautics of the Indiana Department of Revenue conducted an audit of the taxpayer, and noted that taxpayer remitted a miniscule amount of sales tax in their returns. Taxpayer makes note that despite the miniscule amount collected, it has timely remitted sales tax for its leasing operations. The reason such amounts returned each year to the state are so small is because, according to the taxpayer, more individuals were expected to sign up with the club (there are only two flying members), the two members are not using the plane enough (the hourly rate is only $20 an hour), and taxpayer was told by someone at the Department that membership dues are not subject to sales tax. While taxpayer might have been told this, membership dues are indeed subject to sales tax. Aeronautics determined that taxpayer was not entitled to the sales and use tax exemption. The department concurs for several reasons, two of which need only be mentioned.

The first reason is that taxpayer's operating agreement did not create a leasing arrangement between the three individuals. Instead, it created a fractional ownership arrangement. To join the flying club, new members have to purchase "membership units." They are, in actuality, buying an ownership interest in the airplane. The

guarantor expressed in the hearing that the members become part owners of the airplane for "liability purposes." This may be sound business planning; however, this arrangement, as established by the Operating Agreement, has the effect of disqualifying taxpayer from the exemption.

The law concerning the exemption for rental to others is further explained at 45 IAC 2.2-5-15(c)(1) as follows:

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. *This exemption does not apply to purchasers who intend to consume or use the property* or add value to the property through the rendition of services or value to the property through the rendition of services or performance of work with respect to such property. [*emphasis added*].

It is well established that in Indiana tax exemptions are strictly construed and taxpayers bear the burden of proving entitlement to an exemption. *Indiana Dept. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003). The owners of the airplane (with the exception of the guarantor) were the only individuals using the plane. The members became owners, and not lessees, of the flying property. These individuals "intend[ed] to. . .use the property," and thus could not qualify for the exemption under 45 IAC 2.2-5-15(c)(1). Taxpayer has not offered any reason why the selling of ownership shares in an airplane should be considered a leasing arrangement.

The second reason that the taxpayer does not qualify for the exemption can be found in its own insurance policy. Taxpayer maintained at the hearing that it is insured for commercial use of the plane. It is the taxpayer's contention that he spoke with the insurance agent about getting the appropriate coverage, and that it would not have been able to get any other coverage given that the name of the LLC contains the word "leasing." Regardless, the fact remains that the insurance policy clearly states that "[t]he *aircraft* will be used only for *non-commercial use*." [*emphasis contained in the original document*].

It is important to note that the taxpayer received a lower rate on its insurance because the only people that were supposed to be flying the plane were the aircraft owners, who were supposed to be operating a non-commercial aircraft. It is unreasonable for the taxpayer to expect the Department to believe that the taxpayer would not have been aware of this provision or of the lower insurance rate that it was receiving. This insurance issue ties into the ownership conundrum that taxpayer has put itself in. As owners of an aircraft being insured by a company with the understanding that the plane can only be insured for non-commercial use, taxpayer has again clearly shown that it is not in the business of renting or leasing.

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). In addition, the Indiana Supreme Court has stated:

It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

*Indiana Dept. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003). Taxpayer has not fulfilled either requirement. It has not presented any compelling argument as to why the assessment was inaccurate, nor has it presented a compelling reason as to why it qualifies for the sales and use tax exemption. Taxpayer is clearly not operating as a leasing enterprise, as shown by the terms of its own operating agreement and the terms of its insurance policy. Taxpayer has failed to meet its burden of proof, and the assessment stands as it is.

**FINDING**

Taxpayer's protest is denied.

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