

**Letter of Findings Number: 06-0331
Sales/Use Tax
For the Year 2005**

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ISSUE

I. Sales/Use Tax--Leasing

Authority: IC § 6-2.5-5-8; *Indiana Dep't of Revenue v. Interstate Warehousing*, 783 N.E.2d 248 (Ind. 2003).

Taxpayer protests a use tax assessment for an airplane.

STATEMENT OF FACTS

Taxpayer is a limited liability company. An S corporation ("Corporation") owns eight percent of Taxpayer, while an individual ("Individual Member") owns ninety-two percent of Taxpayer. Individual Member owns all the shares of Corporation.

In 2005, Taxpayer purchased an airplane for \$3,550,000. At the time of purchase, Taxpayer presented the seller a sales tax exemption certificate, claiming that Taxpayer purchased the plane for renting or leasing to other persons. By presenting the exemption certificate, Taxpayer did not pay sales tax at the time of purchase.

Taxpayer entered into a leasing agreement with Corporation. Taxpayer charged Corporation \$1,000 per hour to lease the airplane. Taxpayer also charged Corporation a \$25,000 per month "convenience fee." Taxpayer neither leased the plane to any other person, nor provided evidence of attempts to lease the plane to another person other than Corporation.

In 2006, roughly one year after purchasing the plane, Taxpayer sold the plane to an unrelated third party.

The Indiana Department of Revenue ("Department") issued a use tax assessment against Taxpayer. Taxpayer protested the assessment. The Department conducted a hearing, and this Letter of Findings results. Additional facts will be supplied as necessary.

I. Sales/Use Tax--Leasing

DISCUSSION

Taxpayer claims that the purchase of the aircraft was exempt from sales and use tax because Taxpayer rented or leased the aircraft. The statutory exemption for tangible personal property IC § 6-2.5-5-8 provides:

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.

Exemptions from taxation are strictly construed against taxpayers. *Indiana Dep't of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003).

With respect to the protested aircraft, Taxpayer's initial intent is unclear. Taxpayer indicated that it purchased the aircraft for "renting or leasing" in the ordinary course of Taxpayer's business.

However, Taxpayer also indicated that it regularly bought and sold aircraft in its regular business. In effect, the resale of the aircraft was its actual intent with respect to the aircraft. Even though Taxpayer claimed that its business was the purchase and resale of aircraft, Taxpayer has not filed the appropriate registration form for aircraft dealers.

With respect to the parties to the lease, Individual Member controlled both Taxpayer and Corporation. Furthermore, with respect to a loan issued to Taxpayer, Individual Member was the personal guarantor of the loan. The close relationship between Taxpayer, Corporation, and Individual Member requires close scrutiny of the terms and conditions of the purported leasing arrangement—closer scrutiny than that between unrelated parties. However, the close relationship is not in and of itself fatal to the leasing contract.

Taxpayer argues that the lease terms it charged Corporation represented an arms-length market rate for rentals of aircraft. Taxpayer included an opinion from a professional aircraft appraiser. The appraisal also concluded that the fair market value for leasing the aircraft under the terms of Taxpayer's lease--i.e., the lessor is not providing a crew and paying various other costs--was between \$800 and \$1,000 per hour. Taxpayer charged \$1,000 per hour when the aircraft was leased.

During the year that Taxpayer leased the plane, Corporation flew the plane an average of twenty six hours per month. Taxpayer charged Corporation an appropriate amount of sales tax for the per-hour lease payments, but did not charge sales tax with respect to the "convenience fees." Taxpayer reported the rental income on its Indiana sales tax returns and remitted sales tax for the rental fees.

In addition, Taxpayer and Corporation provided records that demonstrated that Corporation paid Taxpayer the amounts specified in the lease, with the lease amounts subtracted from Corporation's bank accounts and added to Taxpayer's bank accounts. The bank account information also did not demonstrate a circular flow of

funds between the entities that otherwise would have undercut the purported arms'-length relationship. However, because both Taxpayer and Corporation were pass-through entities for income tax purposes, the ultimate income tax payer—Individual Member—realized no net income or losses from the transaction.

Taxpayer also purchased an insurance policy with respect to the aircraft. The insurance policy provided for coverage in various events, but did not limit Taxpayer's right to lease the aircraft.

However, the insurance policy lists Taxpayer's business as "advertising." The insurance policy states that "Aircraft Use: You may use the aircraft for all operations incidental to your business." Advertising is *Corporation's* line of business. According to Taxpayer's protest letter, "Taxpayer is engaged in the business of purchasing, selling, owning and leasing aircraft (the 'Aircraft Business')." The advertising business specified as Taxpayer's business compels the Department to conclude that the aircraft was purchased for *Corporation's* business use, rather than for leasing in the ordinary course of Taxpayer's business. Based on the airplane not being used for renting or leasing in Taxpayer's ordinary course of business, the Department's determination that the aircraft was subject to use tax was correct.

FINDING

Taxpayer's protest is denied.

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