DEPARTMENT OF STATE REVENUE

04-20060459.LOF

Letter of Findings: 06-0459
Sales and Use Tax
For the Year 2006

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax – Imposition on Aircraft Purchase.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-2.5-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-5-15; *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax. Ct. 2007); *Indiana Dept. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003).

Taxpayer protests denial of rental exemption and subsequent imposition of use tax on the purchase of an aircraft.

II. Tax Administration – Imposition of Negligence Penalty.

Authority: IC § 6-8.1-10-2.1, 45 IAC 15-11-2 (b)(c).

The Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, a single-member LLC formed on June 1, 2006, purchased an aircraft on June 22, 2006, but did not pay sales tax on the purchase, claiming an exemption for rental or lease to others. The Indiana Department of Revenue ("Department") reviewed the claim for exemption and determined that taxpayer did not qualify for the exemption. The Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment and the associated negligence penalty. A hearing was held where Taxpayer was represented by counsel. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition on Aircraft Purchase.

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289, 292 (Ind. Tax. Ct. 2007).

Indiana imposes a use tax on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2; 45 IAC 2.2-3-4. IC § 6-2.5-3-4(a)(2) allows for a use tax exemption for property that is acquired in a transaction that is exempt from sales tax under IC § 6-2.5-5, and the property is being stored, used, or consumed for the purpose for which it was exempted. One of those exemptions is found at IC 6-2.5-5-8(b) which states that,

> 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 rental exemption set out in IC § 6-2.5-5-8 is further explained in 45 IAC 2.2-5-15, which states:

> (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
>
> (b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:
>
> (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;
>
> (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
>
> (3) The property is resold, rented or leased in the same form in which it was purchased.
>
> (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 performance of work with respect to such property.
>
> (2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the exemption have been met. *Indiana Dep't. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003). The Department will strictly construe the exemption statutes against the taxpayer claiming the exemption. *Id*.

Taxpayer stated that it was in the business of renting the aircraft and therefore qualified for the rental exemption on the airplane. This exemption requires, therefore, compliance with three elements.

One of these requirements is that the airplane must be purchased with the intention of renting the airplane. Taxpayer stated as much and submitted the "Minutes of the Initial Meeting of Members" containing language that substantiates that the airplane was purchased for the purpose of "rental pursuant to written aircraft rental agreements." Taxpayer's subsequent activities relating to the aircraft bear out this stated intention.

Another of these requirements is that Taxpayer must be engaged in the reselling, renting, or leasing of such property in its regular course of business. Taxpayer entered into two agreements with the same enterprise (Agent) dated June 14, 2006, and August 1, 2006. At the hearing, Taxpayer stated that the second agreement superseded the first one.

Pursuant to the August 1, 2006, agreement, Taxpayer hired Agent to act as its agent to arrange for the use of its aircraft by Agent's flight school members. The agreement can be terminated upon thirty (30) days written notice. Agent charges thirty-seven dollars ($37) per hour for each flight hour incurred by Taxpayer's aircraft during the term of the agreement (other than flight hours by owner who must be a member of the flight school in order to fly the plane). This fee covers Agent's scheduling service, routine daily maintenance services and logbook review, scheduling and coordination of maintenance (to be performed by Agent or outside vendors), ordering parts or supplies, and local ferry and test flights.

Also, Agent is reimbursed, on a monthly basis, for any additional expenses incurred on behalf of Taxpayer. Per the agreement, Taxpayer is to pay the insurance premiums on the insurance policy obtained by Agent. Taxpayer is to pay all taxes, licenses and permit fees, and is to timely pay all home-base or maintenance related tie-down or storage fees. Taxpayer is to provide fuel accounts for the aircraft with fuel vendors as designated by Agent. Agent is to provide Taxpayer with monthly statements of the aircraft's use and operating expenses.

Per the agreement, Agent rents the aircraft to its flight school's member pilots and instructors. Taxpayer is to determine, with the assistance of Agent, the amount that the members of Agent's flight school will be charged for hourly use of the aircraft. Agent may adjust the fee charged to is flight school members "in order to reflect the cost of operation and ownership." Per the agreement, the initial fee is one-hundred and twenty-nine dollars ($129) per hour wet. Per the agreement, Agent is to collect the hourly charges from its flight school's members and remit the net amount - after payment of the thirty-seven dollars ($37) per hour operations fee and reimbursement for any expenses incurred on the Taxpayer's behalf - on a monthly basis. Agent agrees that it will not provide Taxpayer with more than a total of eight hours of operations per month, unless approved by Taxpayer.

Taxpayer has provided copies of these detailed, monthly income and expense reports for July, August, September, October, November, and December of 2006. Taxpayer also provided detailed flight logs for July, August, September, and December 2006, but none for October and November of 2006. The reports show Taxpayer being credited for ninety-two dollar ($92) per Hobbs hour.

Taxpayer has not provided any invoices or receipts given to flight school members who fly the aircraft to show that sales tax is being collected on those particular transactions. Although Agent purportedly collected sales tax each time it rented the airplane on behalf of Taxpayer, Agent did not remit sales tax directly in the name of the Taxpayer. Therefore, whatever sales tax was collected on the rental transactions, was remitted by and credited to Agent. On its face, this would seem to indicate that *Agent* is renting the aircraft. Taxpayer submitted Agent's ST-103s for July, August, September, October, November and December of 2006, showing that Agent remitted sales tax to the Department, but there is nothing that points to Taxpayer's portion of those sales tax remittances. According to Taxpayer's representative, Agent combines all remittances to the Department, not just Taxpayer's. Taxpayer reports sales to the Department on a monthly basis, but exempts itself from sales tax on those sales. In a letter dated August 23, 2006, Taxpayer said that it did not remit sales tax on the rental revenue on its own ST-103s because it does not utilize the airplane. Taxpayer is mistaken. Agent is merely acting as Taxpayer's agent in the rental of the aircraft. The duty to collect and remit sales tax on these rental transactions rests with the Taxpayer. Agent collects these taxes on behalf of Taxpayer. Agent may remit these taxes to the Department on behalf of Taxpayer, however they must be traced back to Taxpayer and identified in the fulfillment of Taxpayer's legal obligation to collect and remit these taxes.

Taxpayer confirmed that Agent collects and remits sales tax on the full amount charged to Taxpayer's customers. The rate itself qualifies as a reasonable market rate for the aircraft in question.

Taxpayer did not fully document its single member's use of the aircraft. Taxpayer stated that its single member pays the market rate when he flies the aircraft as a member of Agent's flight school. The agreement states that Agent is not to charge Taxpayer its operating fee of thirty-seven dollars ($37) when Taxpayer's single member uses the aircraft. Taxpayer did represent that the aircraft is used strictly through the flight school, and the agreement reflects that Taxpayer's single member uses the aircraft as a member of Agent's flight school. Per Taxpayer, there is no other affiliation between Taxpayer and Agent. The July and August 2006 flight logs show

Taxpayer's single member using the aircraft twenty-five percent and ten percent of the time respectively for those months, with no use by Taxpayer's single member in December of that year. It does appear that Taxpayer's single member paid at least ninety-two dollars ($92) per hour, because his use shows up as income to Taxpayer at that rate.

Assuming that Agent can verify that it collected market rate rental amounts each time it rented the airplane and that Agent can distinguish and verify the amount of sales tax which should have been collected in Taxpayer's name, Taxpayer will have sustained its burden of proving that the airplane was purchased for the purpose of renting it in Taxpayer's ordinary course of business as required by IC § 6-2.5-5-8.

FINDING

Taxpayer's protest is sustained, subject to audit verification that market rates were charged, and sales taxes were collected and remitted to the Department.

II. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
>
> The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:
>
> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
>
> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
>
> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

While Taxpayer has gone a long way in documenting its business transactions to substantiate its operation as an aircraft leasing entity, it has failed to properly account for collecting and remitting sales tax on its rental transactions. Taxpayer was sustained on the first issue subject to audit verification that market rates were charged, and sales taxes were collected and remitted to the Department.

FINDING

If audit verifies that market rates were charged, and sales taxes were collected and remitted to the Department, then the penalty liability is moot.

However, if audit is unable to verify the above, then Taxpayer's protest is respectfully denied.

Posted: 12/05/2007 by Legislative Services Agency
An html version of this document.