

**Letter of Findings Number: 07-0434
Sales and Use Tax
For the Tax Period 2006**

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ISSUE

I. Sales and Use Tax - Imposition

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); [IC 6-2.5-3-2\(c\)\(1\)](#); IC § 6-6-6.5-8(d); [45 IAC 2.2-5-15](#); Indiana Dep't of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003).

The Taxpayer protests the assessment of use tax on an airplane.

II. Tax Administration - Ten Percent 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

The Taxpayer is a wholly owned subsidiary and disregarded entity of a corporation that is in the business of renting airplanes. The parent corporation desired to expand its fleet to contain a rental jet airplane. To segregate the jet from the remainder of the fleet for insurance purposes, the parent corporation created the Taxpayer to purchase and hold the jet. The Taxpayer bought a jet airplane in 2006 without paying sales tax at the time of purchase. The Indiana Department of Revenue, hereinafter referred to as the "Department," assessed Indiana use tax, interest, and penalty on the jet airplane. The Taxpayer protested the assessment of use tax, contending that the jet qualified for the rental exemption. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax - Imposition

DISCUSSION

All tax assessments are presumed to be valid. IC § 6-8.1-5-1(b). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.* Exemption statutes are to be strictly construed against the Taxpayer. *Indiana Dep't of State Revenue v. Interstate Warehousing*, 783 N.E.2d 248 (Ind. 2003).

Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC § 6-2.5-3-2. 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 or proof that the taxes are inapplicable because of an exemption.

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

(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 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.

The Taxpayer argued that functionally the Taxpayer and the parent corporation were one and the same entity except for liability insurance purposes. The Taxpayer was a disregarded entity of the parent. The parent corporation conducted and paid for all of the Taxpayer's operations, administration, and management. Since the corporations were essentially the same corporation, the Taxpayer argued that the parent corporation's rental of the jet airplane to third parties qualified the jet for the rental exemption from the use tax.

The Department disagrees with the Taxpayer's conclusion that the parent corporation and Taxpayer were essentially the same corporation. Both corporations were set up as individual corporations with separate incorporation documents, by-laws, and Secretary of State registrations. Status as a disregarded entity for adjusted gross income tax purposes does not make a corporation disregarded for sales and use tax purposes.

Alternatively, the Taxpayer argued that if the Department considered the corporations truly separate entities, the Taxpayer qualified for the rental exemption on its own merits. The Taxpayer was a registered retail merchant in the business of renting airplanes – with its only rental airplane being the jet that is the subject of this protest. The Taxpayer offered a rental agreement between it and the parent corporation to substantiate its contention that it leased the jet to the parent corporation. There was, however, no evidence of rental payments ever having been made. The Taxpayer stated that the failure to collect rental payments stemmed from the length of time it took to obtain federal regulatory permission to rent the jet. However, during the period before the federal regulatory permission was obtained, the Taxpayer allowed the parent corporation to use the plane for training and maintenance trips without collecting rent from the parent corporation. The lease agreement stated that training and maintenance trips rental rate was \$0.00 per hour. After notification by the Department, the parent corporation submitted use tax payments on behalf of the Taxpayer for the training and maintenance flights. This evidences that the lease was entered into merely as a formality. The substance of the arrangement was that the Taxpayer allowed the parent corporation to use the plane without receiving rental payments. This was a taxable use of the jet airplane.

The Taxpayer failed to sustain its burden of proving that its use of the jet airplane was exempt from the use tax pursuant to IC § 6-2.5-5-8.

FINDING

The taxpayer's protest to the assessment of use tax on its airplane is respectfully denied.

II. Tax Administration - Ten Percent Negligence Penalty

DISCUSSION

The Taxpayer protests 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.

The Taxpayer provided substantial documentation to indicate that its failure to pay the assessed use tax was due to reasonable cause rather than negligence.

FINDING

The Taxpayer's protest to the imposition of the penalty is sustained.

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