

Letter of Findings: 07-0450
Sales and Use Tax
For the Year 2006

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ISSUES

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

Authority: IC § 6-8.1-5-1; IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-6-6.5-8(d); [45 IAC 2.2-5-15](#); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax. Ct. 2007); *Indiana Dept. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248 (Ind. 2003); *Indiana Dep't of Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

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](#).

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

STATEMENT OF FACTS

Taxpayer was formed as an Indiana corporation on December 1, 2006. Taxpayer is a wholly-owned subsidiary of an Indiana S corporation (Parent). Taxpayer purchased the subject aircraft on December 5, 2006, for \$485,000. Taxpayer 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. On July 25, 2007, the Department denied the exemption and issued a proposed assessment for use tax, interest, and penalty on use of the aircraft in Indiana. Taxpayer protested the assessment and the associated negligence penalty. A hearing was held. 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 prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

On initial review, the Department found that Taxpayer had purchased an aircraft without paying sales tax at the time of purchase, and assessed use tax on the purchase.

IC § 6-2.5-2-1 provides:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-3-2(a) provides:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Accordingly, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Additionally, IC § 6-6-6.5-8(d) provides for the payment of sales or use tax on an aircraft, 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.

Taxpayer contends that Taxpayer's use of the aircraft qualified for an exemption, therefore, Taxpayer did not pay the sales or use tax at the time of purchase. Taxpayer asserts that the Taxpayer's purchase of the aircraft meets the rental to others exemption.

The rental to others exemption is provided in IC § 6-2.5-5-8(b), as follows:

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 his business without changing the form of the property.

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, rental 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.

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 a provision in IC § 6-2.5-5 if the property is being stored, used, or consumed for the purpose for which the property was exempted.

In applying any tax exemption, the general rule is that tax exemptions are strictly construed in favor of taxation and against the exemption. *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). 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. *Interstate Warehousing*, 783 N.E.2d at 250.

The aircraft is properly titled, registered and insured. Taxpayer has executed rental agreements with its Parent and with an individual who is the principal of both Taxpayer and Parent. The agreements require the lessees to pay operating costs. According to the agreements, the operating costs include, "crew costs, employee benefits, landing, handling, fuel, lubricants, any and all other consumables, and custom fees and related charges." The agreement also requires the payment of hourly rental fees of \$100 (Parent) or \$150 (individual) plus sales tax. Taxpayer argues that the rental rates for the subject aircraft are equivalent to the general market rate for the aircraft, but provides no evidence to that effect. The Department is unable to substantiate that this is a market rate since the lessees pay for operating costs. Taxpayer provided flight logs for use of the aircraft in 2007 showing: no flights logged in the first quarter, 27.8 hours in the second quarter, 8.3 hours in the second quarter, and 47.8 hours logged in the last quarter. Taxpayer has remitted sales tax to the Department for the second, third and fourth quarters of 2007. Taxpayer has not yet remitted sales tax to the Department in 2008.

Taxpayer submitted billings from a law firm doing work for Parent that shows that Parent was attempting to acquire "an FBO and Part 135 charter certificate." Taxpayer states, in a letter dated January 22, 2008, that, "these efforts are continuing, confirming the commitment of the company to expand its aircraft rental and leasing operations." This information, however, goes to Taxpayer's future plans which have not yet come to fruition.

The Department refers to IC § 6-2.5-5-8(e), which provides, as follows:

This subsection applies only after June 30, 2008. A transaction in which a person acquires an aircraft for rental or leasing in the ordinary course of the person's business is not exempt from the state gross retail tax unless the person establishes, under guidelines adopted by the department in the manner provided in [IC 4-22-2-37.1](#) for the adoption of emergency rules, that the annual amount of the lease revenue derived from leasing the aircraft is equal to or greater than:

(1) ten percent (10 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was less than one million dollars (\$1,000,000); or

(2) seven and five-tenths percent (7.5 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was at least one million dollars (\$1,000,000).

While this statute is not yet in effect for a 2007 aircraft purchase, it is a useful guide of what constitutes reasonable annual rental revenues for a person occupationally engaged in renting or leasing an aircraft. Here, the aircraft in question's purchase price was \$485,000. As provided by IC § 6-2.5-5-8(e)(2), after June 30, 2008, the annual amount of lease revenue that Taxpayer derives from the leasing of the aircraft would need to be equal or greater than ten (10) percent of the greater of the original cost or the book value of the aircraft in order for

Taxpayer to qualify for the exemption; i.e., a minimum of \$48,500.

In this instance, Taxpayer would have needed to generate \$48,500 in sales for 2007 to qualify for the sales tax exemption on the purchase of the aircraft. Taxpayer generated \$9,158 in sales, less than twenty percent of that required threshold. At hearing Taxpayer described extenuating maintenance issues that impacted the availability of the aircraft for rentals during 2007. Subsequent to the hearing, Taxpayer substantiated this with invoices that document ongoing maintenance on the aircraft through the end of August 2007. As stated above, Taxpayer's records indicate there was some rental activity during this period, however, it is clear that Taxpayer's rental activity increased in the last quarter of the year (\$5,275 in sales), presumably once the maintenance issues were resolved. However, even if sales are extrapolated from the last quarter to the previous three quarters (last quarter sales multiplied by four), Taxpayer's sales would still only be forty-five percent of the required threshold.

Therefore, based upon the evidence presented, the Department is unable to conclude that Taxpayer was "occupationally engaged in reselling, renting, or leasing such property in the regular course of his business." [45 IAC 2.2-5-15\(b\)\(2\)](#). Thus, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c). It is noted that Taxpayer remitted sales tax on its rental stream in 2007. The lessee may timely claim a refund of these remitted taxes once it pays the 2006 use tax assessment.

FINDING

Taxpayer's protest is respectfully denied.

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.

Taxpayer has gone a long way in documenting its business transactions in order to support its claims. While Taxpayer's application for the aircraft lease exemption is denied, the Department recognizes that Taxpayer has nonetheless promptly acted, within its understanding, to collect sales tax on its transactions.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Use tax is due on the purchase price of the aircraft.

The ten-percent negligence penalty is waived.

Taxpayer may file a claim for refund of the sales tax it remitted on its rental stream for 2007 once it pays the 2006 use tax assessment.

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