

Letter of Findings Number: 07-0547
Sales and Use Tax
For the Tax Year 2007

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ISSUES

I. Sales and Use Tax—Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-5; 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; IC § 6-8.1-5-1; [45 IAC 2.2-5-15](#); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests the assessment of use tax on an aircraft.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten (10) percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation that purchased an aircraft on June 18, 2007, by trading-in two other aircraft in "like kind exchanges" and paying \$1,198,815 in cash. Taxpayer did not pay sales tax at the time of 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 October 1, 2007, the Department denied the exemption and issued a proposed assessment for use tax, interest, and penalty on Taxpayer's use of the aircraft in Indiana. Taxpayer protested this imposition of the tax and penalty. A hearing was held, and this Letter of Findings results. Additional facts will be supplied as required.

I. Sales and Use Tax—Imposition.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

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 aircrafts 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 State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

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 in the business of renting or leasing an aircraft. Here, the aircraft in question's purchase price was just over \$4,900,000. 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 seven and one-half 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 \$367,500.

During the course of the protest, Taxpayer submitted a lease from a related party and a flight log for the 2006 tax years to demonstrate the business use of this aircraft. However, a flight log for the 2006 tax year would not contain the flight information for the aircraft in question, which was not purchased until June of 2007. A review of the Department's sales tax records shows that Taxpayer did remit sales tax on \$16,000 of monthly revenue that it collected for the rental of this aircraft to the related party from July 2007 to March 2008. Nevertheless, even if this \$32,000 of revenue collected on which sales tax was remitted is projected for the remainder of 2008, Taxpayer's annual lease revenue does not meet the revenue requirement that takes effect after June 30, 2008, found in IC § 6-2.5-5-8(e)(2).

Taxpayer asserts that the Department's use of the \$4,900,000 as the "original cost or book value of the aircraft" is inconsistent with the fact that Taxpayer purchased this aircraft by trading-in two other aircraft in "like kind exchanges" and paying \$1,919,815 in cash. Taxpayer maintains that since IC § 6-2.5-1-5(b)(1) contemplates an exclusion from sales tax at the time of purchase for the "like kind exchange" property given, the annual amount of lease revenue that Taxpayer is required to derive from the leasing of the aircraft should be based upon this amount that was subject to sales tax at the time of purchase; i.e., an amount equal to or greater than seven and one-half percent of the \$1,198,815 or a minimum of \$89,911.

However, the Department declines to accept Taxpayer's invitation to use the amount of cash that exchanged hands at the time of purchase instead of the "original cost or book value of the aircraft" that Taxpayer is claiming to be in the business of renting or leasing as provided in IC § 6-2.5-5-8(e). Taxpayer's assertion focuses on only the cash expended in the acquisition of the aircraft and fails to take into account the value of the aircraft that it placed into business to produce a rental stream. Regardless of how the purchase of the asset was financed, the

Indiana Legislature has recommended that the comparison of the value of the asset to the income derived from the rental of the asset be the determinative factor for whether a person is occupationally engaged in the business of renting and leasing.

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 sale tax on its rental stream of income in 2008 on behalf of its lessee. The lessee may claim a refund of these remitted taxes.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and ten (10) percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

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 Department may waive a negligence penalty as provided in [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 provided sufficient information to establish that its failure to pay the deficiency was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#).

FINDING

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

CONCLUSION

In summary, Taxpayer's protest of the assessment of use tax is denied, and Taxpayer's protest to the imposition of penalty is sustained.

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