

Letter of Findings Number: 08-0218
Sales and Use Tax
For the Tax Years 2006 and 2007

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ISSUES

I. Sales and Use Tax—Imposition.

Authority: 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 § 6-8.1-5-1; [45 IAC 2.2-4-27](#); [45 IAC 2.2-5-15](#).

Taxpayer protests the assessment of use tax on two aircraft.

II. Penalty—Imposition.

Authority: [IC 6-8.1-10-1](#); IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana limited liability company. Taxpayer acquired an aircraft in May 2006 and another aircraft in December 2006. At the time of the purchases, Taxpayer was not registered with the Department to collect and remit sales tax. Taxpayer has an affiliate that is in the business of providing flight training and aircraft rental. Taxpayer's affiliate collected and remitted tax, on behalf of Taxpayer, on all rental revenue. After an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer purchased the aircraft without paying sales tax at the time of purchases, and assessed use tax, interest, and penalty for the 2006 and 2007 tax years. Taxpayer protested this imposition of the tax and penalty. An administrative hearing was held, and this Letter of Findings results. Further facts will be provided 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. In this instance, the Department found that Taxpayer had purchased two aircraft without paying sales tax at the time of purchases, and assessed use tax on the purchases.

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.

When sales tax is not properly paid on the purchase of an otherwise taxable item, the Department may assess and impose a use tax pursuant to IC § 6-2.5-3-2(a), which states:

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 when the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of the purchases, the Department found that the purchases were subject to use tax.

Taxpayer maintains that since Taxpayer's use of the aircraft qualified for an exemption, Taxpayer did not need to pay sales tax on the purchases of the two aircraft at the time of purchase. Taxpayer claims that the purchases of the aircraft were exempt from sales tax under the "rental exemption" found in IC § 6-2.5-5-8(b). The "rental exemption" is provided in IC § 6-2.5-5-8(b), 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 the person's 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.

Therefore, a taxpayer who buys an aircraft for the purpose of leasing it to others is not required to pay sales tax on the initial purchase price because the purchase of the aircraft is for an exempt purpose.

However, Indiana also requires that the gross retail tax be collected on income received from the rental of tangible personal property. [IC 6-2.5-2-1](#). [45 IAC 2.2-4-27](#)(c) states that, "In general, the gross receipts from renting or leasing tangible personal property are subject to tax."

A. "Occupationally Engaged in Leasing."

Taxpayer asserts its sole purpose for acquiring the aircraft was to provide flight training and aircraft rental through a lease agreement with an affiliated company. Taxpayer's intent to lease the tangible personal property, however, is not enough by itself to support a finding that the purchases of the aircraft were exempt from sales tax. In addition to possessing the requisite intent, Taxpayer must also be "occupationally engaged in reselling, renting or leasing such property in the regular course of his business." The Department refers to [45 IAC 2.2-5-15](#)(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.

Taxpayer has not provided the Department with sufficient evidence for the Department to determine that Taxpayer is occupationally engaged in reselling, renting, or leasing aircraft. Moreover, a review of the Department's records shows that Taxpayer was not registered as a retail merchant with the Department to collect and remit sales tax during the years at issue. Since Taxpayer has not met its burden to produce such evidence, the Department is without sufficient evidence to find that it qualifies for the "rental exemption" provided in [IC § 6-2.5-5-8\(b\)](#).

B. "Remittance of Tax by Affiliate."

During the course of the protest, Taxpayer provided the Department with various documents, payment summaries, and monthly invoices showing that Taxpayer's affiliate paid rent to Taxpayer, and Taxpayer reported those payments as income on its tax returns. Additionally, Taxpayer provided the Department with summaries of flights, including hours operated in each aircraft, the names of its affiliate's customers, corresponding receipts, as well as copies of numerous tax records all indicating that Taxpayer's affiliate collected tax on each rental transaction, and that those amounts were remitted to the Department by Taxpayer's affiliate.

While [IC § 6-2.5-5-8\(e\)](#) is not determinative of this issue (due to the timing of the purchases), it is worth noting that Taxpayer's lease revenue derived from the leasing of the two aircraft more than satisfies the ten percent threshold requirement contained therein. [IC § 6-2.5-5-8\(e\)](#) states, in pertinent part:

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 . . . that the annual amount of the lease revenue derived from leasing the aircraft is equal to or greater than:

(1) [ten 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). . .

While the Department notes that Taxpayer, not its affiliate, should have been remitting tax on all rental amounts paid to its affiliate, Taxpayer has provided sufficient information to establish that tax was collected on all rental transactions of the aircraft and remitted to the Department, albeit by the wrong entity (Taxpayer's affiliate). Additionally, the taxes that were collected by Taxpayer's affiliate and remitted to the Department exceeded the threshold requirement contained in [IC § 6-2.5-5-8\(e\)](#). After the Department's investigation, Taxpayer has registered as a retail merchant with the Department to collect and remit tax on all rental revenue. In the future, in order to qualify for the rental exemption, Taxpayer must remit tax on all revenue of the rental stream under its retail merchant certificate.

Since all tax due was collected and remitted, the Department waives the assessment of use tax discussed herein. The Department notes that should Taxpayer fail to comply with the substantive requirements discussed herein, even if all tax due is remitted by Taxpayer's affiliate or a third party, the Department will not grant such a waiver again.

FINDING

Taxpayer's protest is sustained.

II. Penalty–Imposition.

DISCUSSION

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.

Since the Department has waived the assessment of use tax discussed in Issue I, there are no remaining deficiencies on which to impose a penalty.

FINDING

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

CONCLUSION

In summary, Taxpayer's protest is sustained on both Issue I and Issue II.

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