

Letter of Findings Number: 07-0497
Sales and Use Tax
For Tax Year 2007

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ISSUES

I. Sales and Use Tax – Rental Exemption.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-5; IC § 6-2.5-5-8; IC § 6-8.1-5-1; [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 Dep't. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

Taxpayer protests the denial of its eligibility for the rental exemption.

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 percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a Nevada single-member LLC registered in Arizona as a foreign LLC doing business in Arizona. On December 19, 2006, Taxpayer purchased an aircraft for \$2,790,000. The aircraft is registered in Arizona where registration is required of Arizona-based aircraft, and is registered with the FAA to Taxpayer with an Arizona domicile.

Taxpayer leases its aircraft to its owner ("LLC B") in an exclusive affiliated company leasing relationship. LLC B is the operator of the aircraft. LLC B is owned by a single individual member ("Owner") who was a part-time Indiana resident. The aircraft first landed in Indiana on May 10, 2007.

After a review of the Taxpayer's application for registration and application for rental exemption the Indiana Department of Revenue ("Department") determined that Taxpayer did not qualify for the exemption and issued assessments for use tax based on the purchase price of the aircraft, as well as interest and a ten percent negligence penalty. Taxpayer protested this determination and the assessments. A hearing was held and this Letter of Findings ensues. Further facts will be supplied as required.

This Letter notes that the Department rescinded an initial assessment of tax on the use in Indiana of the aircraft in question due to a valuation and timing discrepancy which were corrected when Taxpayer brought them to the Department's attention.

I. Sales and Use Tax – Rental Exemption.

DISCUSSION

Taxpayer protests the Department's determination that it did not qualify for the Indiana use tax rental and leasing exemption. Taxpayer did not pay sales tax at the time it purchased the aircraft, nor did Taxpayer pay use tax when it registered its aircraft in Indiana.

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b), (c); 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.

The rental and lease exemption 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 Taxpayer must be engaged in the reselling, renting, or leasing of such property in its regular course of business.

Taxpayer stated in writing and at hearing that it was formed as a liability shield. Taxpayer stated that Owner needed an aircraft for his personal transportation needs and his primary concern was the potential liability in owning an aircraft, thus, as expressed at hearing, Owner's business choice to own and operate the aircraft through a limited liability company was to protect his significant personal assets. Taxpayer argues that this is a legitimate business purpose. This business purpose, however, does not on its own describe a business of renting and leasing aircraft. This is especially true because the arrangement for the use of the aircraft is between closely related entities the separate formations of which create the arrangement being claimed for the renting and leasing exemption.

For the year at issue, the lease agreement between Taxpayer and LLC B stipulated that LLC B was responsible for paying the aircraft's fixed costs related to operating the aircraft, such as hangar rental, maintenance, insurance, etc. In light of the new law (see below), Taxpayer reevaluated the terms of its contractual relationships to establish a flat rental rate of \$1,050 per hour to lease the aircraft. Taxpayer completed its accounting for 2007 and reported taxable sales to Indiana and Arizona based upon this flat rental rate.

As of July 1, 2008 the rental and leasing exemption is found at IC § 6-2.5-5-8, which states:

(a) As used in this section, "new motor vehicle" has the meaning set forth in [IC 9-13-2-111](#).

(b) 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 the person's business without changing the form of the property.

(c) The following transactions involving a new motor vehicle are exempt from the state gross retail tax:

(1) A transaction in which a person that has a franchise in effect at the time of the transaction for the vehicle trade name, trade or service mark, or related characteristics acquires a new motor vehicle for resale, rental, or leasing in the ordinary course of the person's business.

(2) A transaction in which a person that is a franchisee appointed by a manufacturer or converter manufacturer licensed under [IC 9-23](#) acquires a new motor vehicle that has at least one (1) trade name, service mark, or related characteristic as a result of modification or further manufacture by the manufacturer or converter manufacturer for resale, rental, or leasing in the ordinary course of the person's business.

(3) A transaction in which a person acquires a new motor vehicle for rental or leasing in the ordinary course of the person's business.

(d) The rental or leasing of accommodations to a promoter by a political subdivision (including a capital improvement board) or the state fair commission is not exempt from the state gross retail tax, if the rental or leasing of the property by the promoter is exempt under [IC 6-2.5-4-4](#).

(e) 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).

Of particular relevance is IC § 6-2.5-5-8(e). This subsection only applies after June 30, 2008. However, while not controlling for an aircraft purchased in 2006, it is a useful guide in the instant case for what the Department

would consider as being in the business of renting and leasing. Here, the aircraft in question was purchased for \$2,790,000 dollars. As provided by IC § 6-2.5-5-8(e)(2), after June 30, 2008, the annual amount of lease revenue derived from leasing of the aircraft would need to be equal or greater than seven and five-tenths percent of the greater of the original cost or the book value of the aircraft in order for Taxpayer to qualify for the exemption. Taxpayer would have needed to make at least \$209,250 in sales in order to qualify for the exemption under the new statutory requirement. A review of the Department's sales tax records shows that Taxpayer reported no sales in 2007 and reported \$159,915 in sales for the first quarter of 2008, upon which it remitted sales tax. No other sales were reported in 2008. Based on Taxpayer's written statements it is presumed that the amount reported for the first quarter in 2008 was intended as 2007 end of year reporting. However, for whichever year the Taxpayer intended to report sales and remit sales tax, Taxpayer would not have met the new statutory guideline in either year.

Therefore, while the seven and a half percent standard described by IC § 6-2.5-5-8(e)(2) did not take effect until after June 30, 2008, it is a useful guide in evaluating what constitutes being in the business of renting and leasing an aircraft. When taken into account with the other documentation Taxpayer has provided, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c).

IC § 6-2.5-3-5 states that "[a] person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property." The aircraft departed from Hollywood, Florida to Hilton Head, South Carolina where official delivery and acceptance of title to the aircraft occurred. Taxpayer paid sales tax in the amount of \$300 to South Carolina where gross retail tax is charged on all purchases made in South Carolina in the amount of five percent of the purchase price or \$300, whichever is less. Taxpayer, therefore is entitled to a \$300 credit for the sales tax it paid South Carolina where it took physical possession of the aircraft.

FINDING

Taxpayer's protest is respectfully denied. Taxpayer is entitled to a \$300 credit for sales tax it paid South Carolina.

II. Tax Administration - Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) 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.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

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.

In this case, taxpayer did not incur a deficiency due to negligence under [45 IAC 15-11-2\(b\)](#), and so was not subject to a penalty under IC § 6-8.1-10-2.1(a).

FINDING

Taxpayer's protest is sustained.

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