

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2015-20ST
July 14, 2016

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the department's official position concerning a specific issue.

ISSUES

Sales and Use Tax - Like Kind Exchanges.

Authority: IC § 6-2.5-1-5; IC § 6-2.5-1-6; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-8; IC § 6-6-6.5-8; [45 IAC 2.2-1-1](#); IRC § 1031; 26 CFR § 1.1031(k)-1; Black's Law Dictionary, Seventh Edition.

A company ("Taxpayer") is seeking a determination as to whether the sale of an airplane qualifies as a like kind exchange in order to affect the tax base for purposes of IC § 6-2.5-5-8.

STATEMENT OF FACTS

Taxpayer is a limited liability company operating in Indiana and other states. Taxpayer rents and leases aircraft it owns to other businesses, including entities related to Taxpayer.

Taxpayer provides the following information for the transaction at issue:

Taxpayer recently engaged in a transaction with [Seller] (the "Transaction"). In said Transaction, [Seller] sold a recently acquired airplane (the "New Plane") to Taxpayer for \$1,525,000.00. [Seller] acquired New Plane for the primary purpose of assisting Taxpayer facilitate an IRC § 1031 tax-deferred gain.

...

Additionally, as part of the Transaction, Taxpayer traded in an airplane that it already owned (the "Old Plane"), which had a value of \$432,700.00 at the time of the Transaction. [Seller] gave Taxpayer credit for the value of Old Plane, and charged Taxpayer a net purchase price of \$1,092,300.00 for New Plane.

...

Because Taxpayer purchased New Plane with the intention that it would continue to rent/lease it to various entities, including related entities, Taxpayer was able to purchase New Plane exempt from Indiana sales tax pursuant to [IC] §§ 6-2.5-5-8(e) and (f). However, per the statutory provisions quoted above, each year Taxpayer is required to collect and remit Indiana sales tax on the stream of lease income equal to at least 7.5% of the amount of the original Indiana sales tax exemption in order to maintain the exempt status of its purchase of New Plane.

DISCUSSION

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" 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." IC § 6-2.5-3-2(a).

For purposes of Indiana tax law, IC § 6-2.5-1-6 defines a "like kind exchange" as follows:

(a) "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:

- (1) the property exchanged is of the same kind or character, regardless of grade or quality; and
- (2) the persons exchanging the property both own the property prior to the exchange.

(b) A "like kind exchange" may be a part of a transaction involving additional consideration other than the exchanged property.

(c) Notwithstanding subsection (a), a "like kind exchange" does not occur when:

- (1) the transaction involves more than two (2) persons; or
- (2) one (1) party to the transaction, through agreement or negotiation with the second party, acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party.

[45 IAC 2.2-1-1](#) provides further guidance on like kind exchanges, stating in relevant part:

(k) Like Kind Exchange: Limited to Two Parties. Non-taxable "exchanges" include only transactions for a swap or barter of property between two parties. Property received in an exchange transaction in which a third party is involved, with or without property, is subject to gross retail tax. This rule is not meant to deny non-taxability of exchanges where one or both of the parties in a two-party exchange employ an agent in carrying out the agreement.

(l) Like Kind Exchange: Property to be Owned by Parties at Time of Exchange. Non-taxable "exchanges" include only transactions in which the property exchanged is owned by the parties thereto at the time the exchange agreement is entered into. Transactions in which the property to be exchanged is acquired by one party after the agreement to exchange has been arranged are taxable. The exchange agreement must specify the definite units or quantity of property to be exchanged. However, "retail merchants" are allowed to consider as non-taxable the full value of tangible personal property of like kind received in allowable exchanges, even though ownership of the property received is encumbered by a conditional sales contract, retail installment contract, or a chattel mortgage.

IC § 6-2.5-1-5(b)(1) provides for a reduction in the gross retail income for like kind exchanges in relevant part:

(a) Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise . . .

...
(b) "Gross retail income" does not include that part of the gross receipts attributable to:

- (1) the value of any tangible personal property received in a like kind exchange in the retail transaction, if the value of the property given in exchange is separately stated on the invoice, bill of sale, or similar document given to the purchaser . . .

Since the gross retail income subject to tax in a retail transaction does not include the value of tangible personal property received in a like kind exchange, only the cash or other consideration received in the transaction would be subject to sales tax.

IC § 6-6-6.5-8(d) provides the following with regards to sales tax owed on the sale of an aircraft:

(d) 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.

IC § 6-2.5-5-8 provides an exemption for the purchase of an aircraft for the purpose of renting or leasing the aircraft as follows:

(e) This subsection applies only to aircraft acquired after June 30, 2008. Except as provided in subsection (h), 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 gross lease revenue derived from leasing or rental of the aircraft, which may include revenue from related party transactions, is equal to or greater than seven and five-tenths percent (7.5%) of the:

- (1) book value of the aircraft, as published in the Vref Aircraft Value Reference guide for the aircraft; or
- (2) net acquisition price for the aircraft.

If a person acquires an aircraft below the Vref Aircraft Value Reference guide book value, the person may appeal to the department for a lower lease or rental threshold equal to the actual acquisition price paid if the

person demonstrates that the transaction was completed in a commercially reasonable manner based on the aircraft's age, condition, and equipment. The department may request the person to submit to the department supporting documents showing the aircraft is available for general public lease or rental, copies of business and aircraft insurance policies, and other documents that assist the department in determining if an aircraft is exempt from the state gross retail tax.

(f) A person is required to meet the requirements of subsection (e) until the earlier of the date the aircraft has generated sales tax on leases or rental income that is equal to the amount of the original sales tax exemption or the elapse of thirteen (13) years. If the aircraft is sold by the person before meeting the requirements of this section and before the sale the aircraft was exempt from gross retail tax under subsection (e), the sale of the aircraft shall not result in the assessment or collection of gross retail tax for the period from the date of acquisition to the date of sale by the person.

Finally, IRC § 1031 allows a taxpayer to postpone paying tax on a gain if the taxpayer takes the proceeds and reinvests them in similar property in a qualifying like kind exchange. Taxpayer provides the following general explanation of IRC § 1031:

Generally speaking, for federal income tax purposes, whenever you sell business or investment property and you have a gain, you are required to recognize the gain at the time of the sale. However, IRC § 1031 provides an exception and allows you to postpone the recognition of the gain if such property is exchanged solely for similar property as part of a qualifying like-kind exchange. The gain that is deferred in a like-kind exchange under IRC § 1031 is tax-deferred, but it is not tax free as it results in an adjustment to the tax basis of the new asset.

Because the net acquisition price for the New Plane is a factor in how much Taxpayer is required to charge its customers for renting or leasing the plane in order to qualify for the exemption in IC § 6-2.5-5-8, Taxpayer wishes to determine if the tax base is reduced because the Transaction is a like kind exchange for sales tax purposes as well as for IRC § 1031 purposes.

It is important to note that even though both IC § 6-2.5-1-6 and IRC § 1031 involve a "like kind exchange," what is defined and qualifies as a like kind exchange in IRC § 1031 for federal income tax purposes and what is defined and qualifies for a like kind exchange in IC § 6-2.5-1-6 for Indiana sales and use tax purposes are not the same. Income tax and sales and use tax are two different types of taxes, each with their own statutes, regulations, and definitions. Nowhere does the Indiana sales and use tax code reference back to IRC § 1031.

One major difference is that for sales and use tax purposes, a like kind exchange must not involve more than two parties. [45 IAC 2.2-1-1](#) makes clear that if there are more than the two parties, then the exchange would not qualify as a like kind exchange for sales and use tax purposes. However, IRC § 1031 exchanges often involve what is called a "qualified intermediary." The IRS allows for a deferred, non-simultaneous IRC § 1031 exchange of up to 45 days if the taxpayer uses one of four different types of "safe harbors" that holds the property and proceeds until the exchange is complete. One of those safe harbors is a "qualified intermediary." See 26 CFR § 1.1031(k)-1.

In scenarios involving a qualified intermediary, there are often more than two parties involved in the IRC § 1031 exchange: the taxpayer, the buyer of the old property ("old buyer"), a seller of replacement property ("new seller"), and the qualified intermediary. IC § 6-2.5-1-6 refers to a "reciprocal exchange," and the word "reciprocal" is defined in Black's Law Dictionary, Seventh Edition as "mutual" and "bilateral." IC § 6-2.5-1-6 would exclude transactions involving a taxpayer, new seller, and old buyer as a like kind exchange, even though that would be permissible under IRC § 1031 and the corresponding Treasury Regulations, because it would not be a reciprocal exchange between two parties. Sales tax would be due on only the cash portion of the retail transaction for the new aircraft, assuming the transaction truly met the definition of a "like kind exchange" for sales tax purposes (which differs somewhat from the § 1031 definition).

However, if a transaction were to involve a § 1031 qualified intermediary, the taxpayer, and another party who is both buying the old property from taxpayer and selling the replacement property to taxpayer, this would not run afoul of the provisions of [45 IAC 2.2-1-1](#) and would still constitute a non-taxable like kind exchange because the Department would consider the qualified intermediary an agent for purposes of [45 IAC 2.2-1-1](#), and taxpayer and the party that is both buying the old property and selling the replacement property as the two parties. In that case, sales tax would be due on only the cash and other consideration portion of the retail transaction for the replacement property, assuming the transaction truly met the definition of a "like kind exchange" for sales tax purposes (which, again, differs somewhat from the § 1031 definition).

Regarding the matter at issue in this case, Taxpayer does not mention whether a qualified intermediary was used in the Transaction. Taxpayer does state that there are only two parties, Taxpayer and the Seller. Therefore, Transaction satisfies the requirement in IC § 6-2.5-1-6(a) that the exchange be between two persons. Further, the planes are "property . . . of the same kind or character," satisfying the requirement found in IC § 6-2.5-1-6(a)(1). Finally, both Taxpayer and Seller owned the Old Plane and New Plane (respectively) prior to the exchange, satisfying the requirement found in IC § 6-2.5-1-6(a)(2).

However, Taxpayer does point out that Seller purchased a New Plane prior to the Transaction in order to facilitate the IRC § 1031 exchange, and refers back to IC § 6-2.5-1-6(c)(2), which provides as follows:

(c) Notwithstanding subsection (a), a "like kind exchange" does **not** occur when:

. . .

(2) one (1) party to the transaction, through agreement or negotiation with the second party, **acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party. (Emphasis added).**

While Seller did purchase a New Plane prior to the Transaction, and Seller's acquisition of the New Plane was pursuant to negotiation and agreement with Taxpayer, Taxpayer maintains that the primary purpose of Seller purchasing the plane prior to Transaction was to facilitate a § 1031 exchange, not to qualify as a like kind exchange for Indiana sale tax purposes. Taxpayer further maintains that although Transaction qualified for a like kind exchange, it was merely a byproduct of qualifying for the § 1031 exchange to defer taxes on capital gains.

Nevertheless, IC § 6-2.5-1-6(c)(2) does not provide that a like kind exchange is disqualified if the primary purpose of acquiring tangible personal property was to qualify for a reduction in the base of the retail transaction for sales tax purposes. Rather, IC § 6-2.5-1-6(c)(2) provides that the primary purpose of the acquisition only has to be for "exchanging that property for like kind property held by the second party." The New Plane at issue may have been acquired in order to qualify for a § 1031 exchange, but a § 1031 exchange can only happen if there is a like kind exchange. In other words, the primary purpose of Seller acquiring a New Plane was to exchange the plane for like kind property held by taxpayer (in order to qualify for a § 1031 exchange).

For that reason, Transaction does not qualify as a like kind exchange. The sales tax base would be the full price paid for the plane, without reduction for the value of the Old Plane, for purposes of IC § 6-2.5-5-8(e). Therefore, Taxpayer must collect an annual amount of the gross lease revenue derived from leasing or rental of the New Plane that is equal to or greater than seven and five-tenths percent (7.5%) of that net acquisition price in order to qualify for the exemption in IC § 6-2.5-5-8.

RULING

Transaction is not a like kind exchange for purposes of IC § 6-2.5-1-6 because Seller's primary purpose in acquiring a New Plane was to exchange the New Plane for Taxpayer's Old Plane. Therefore, the sales tax base of the Transaction would not be reduced, and the full amount of consideration (\$1,525,000.00; i.e., cash and Old Plane) transferred by Taxpayer for New Plane would be the "net acquisition price" for purpose of IC § 6-2.5-5-8(e). Taxpayer must annually collect an amount equal to or greater than seven and five-tenths percent (7.5%) of that net acquisition price from renting or leasing the New Plane in order to qualify for the exemption in IC § 6-2.5-5-8.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

Posted: 08/31/2016 by Legislative Services Agency
An [html](#) version of this document.