INDIANA STATE DEPARTMENT OF HEALTH
MONTHLY CALCULATION
March 2005

INCOME ELIGIBILITY GUIDELINES FOR THE WIC / MCH / CSHCS/HOOSIER HEALTHWISE PROGRAMS
BASED ON HEALTH AND HUMAN SERVICES POVERTY INCOME GUIDELINES

PROGRAM IMPLEMENTATION DATES LISTED BELOW

CSHCS: February 18, 2005 **MCH/Hoosier Healthwise: April 1, 2005** **WIC: July 1, 2005**

The following information must be used by all MCH funded projects, WIC programs, CSHCS programs, and Hoosier Healthwise (HH) recorded on the appropriate enrollment forms. Guidelines for use of this form are as follows: (all calculations other than 185% are calculated from HCFA income guidelines).

CSHCS: To be financially eligible for CSHCS, the gross household income must be less than or equal to 250% of the federal poverty income guidelines. Household means a group of related or non-related individuals who are not residents of an institution, but who are living as one economic unit. The applicant must also be medically eligible to receive services.

MCH: The payment level for MCH Services is at the bottom of the form. It ranges from no charge at or below 100% of federal poverty guidelines to patients being charged the full cost of service (100%) at greater than 200% of federal poverty guidelines. Assignment of an MCH payment level category is based on the participant's annual family/household (economic unit) gross income and size with regard for extenuating circumstances (i.e., substantial financial debt, family members with extraordinary medical bills). The participant's payment level category must be updated annually. This payment level is for persons without insurance to cover services.

WIC: Please note that there is no charge for WIC services and WIC income eligibility cannot exceed 185% of the poverty income levels. Proof of income is required to receive WIC benefits. No allowances for extenuating circumstances can be made. Total household income (gross) must be used; except for self-employed persons, such as a farmer or a small business owner. For this special group use gross income less business expenses. Household consists of a group of related or non-related individuals who are not residents of an institution but who are living as one economic unit.

HH: For a pregnant woman and/or child 0-18, to be financially eligible for package A and B Hoosier Healthwise, the gross economic unit income must be less than or equal to 150% of the federal poverty income. Children 0-19 are eligible for Package C (required variable premium payment) up to 200% of federal poverty income guidelines.

NOTE: CSHCS defines a pregnant woman as one family member. MCH and WIC define a pregnant woman as two family members.

HOUSE HOLD SIZE:	100% MONTHLY Income Starting At	HH A & B 150% MONTHLY Income Equal To Or Less Than	HH Partial Premium Package C 175% MONTHLY Income Equal To Or Less Than	USDA / WIC Standard 185% MONTHLY Income Equal To Or Less Than	HH Full Premium Package C 200% MONTHLY Income Equal To Or Less Than	CSHCS 250% MONTHLY Income Equal To Or Less Than
Size	**100%**	**150%**	**175%**	**185%**	**200%**	**250%**
1	$798	$1,197	$1,396	$1,476	$1,595	$1,995
2	$1,070	$1,604	$1,872	$1,978	$2,139	$2,675
3	$1,341	$2,012	$2,347	$2,481	$2,682	$3,355
4	$1,613	$2,419	$2,822	$2,984	$3,225	$4,035
5	$1,885	$2,827	$3,298	$3,486	$3,769	$4,715
6	$2,156	$3,234	$3,773	$3,989	$4,312	$5,395
7	$2,428	$3,642	$4,249	$4,491	$4,855	$6,075
8	$2,700	$4,049	$4,724	$4,994	$5,399	$6,755
9	$2,971	$4,457	$5,199	$5,497	$5,942	$7,435
10	$3,243	$4,864	$5,675	$5,999	$6,485	$8,115
11	$3,515	$5,272	$6,150	$6,502	$7,029	$8,795
12	$3,790	$5,679	$6,626	$7,004	$7,572	$9,475
Each additional member add	+ $272	+ $408	+ $475	+ $503	+ $544	+ $680
*MCH	<100%	101%-150%	151%	to 185%	186% - 200%	201% - 250%
	0%	**1 – 25%	25%	to 50%	50%	75%

Base Poverty Level is: $798. Federal Register Vol. 70, No. 33, February 18, 2005
***MCH Percentage used to calculate MCH charges. If income is greater than 250%, charge 100%.**
****Clinic choice 1-24% for the cost of service except those covered by HH.**

ANNUAL CALCULATION
March 2005
INCOME ELIGIBILITY GUIDELINES FOR THE WIC / MCH / CSHCS/ HOOSIER HEALTHWISE PROGRAMS
BASED ON HEALTH AND HUMAN SERVICES POVERTY INCOME GUIDELINES
PROGRAM IMPLEMENTATION DATES LISTED BELOW

CSHCS: February 18, 2005 **MCH/Hoosier Healthwise: April 1, 2005** **WIC: July 1, 2005**

The following information must be used by all MCH funded projects, WIC programs, CSHCS programs, and Hoosier Healthwise (HH) recorded on the appropriate enrollment forms. Guidelines for use of this form are as follows: (all calculations other than 185% are calculated from HCFA income guidelines).

CSHCS: To be financially eligible for CSHCS, the gross household income must be less than or equal to 250% of the federal poverty income guidelines. Household means a group of related or non-related individuals who are not residents of an institution, but who are living as one economic unit. The applicant must also be medically eligible to receive services.

MCH: The payment level for MCH Services is at the bottom of the form. It ranges from no charge at or below 100% of federal poverty guidelines to patients being charged the full cost of service (100%) at greater than 200% of federal poverty guidelines. Assignment of an MCH payment level category is based on the participant's annual family/household (economic unit) gross income and size with regard for extenuating circumstances (i.e., substantial financial debt, family members with extraordinary medical bills). The participant's payment level category must be updated annually. This payment level is for persons without insurance to cover services.

WIC: Please note that there is no charge for WIC services and WIC income eligibility cannot exceed 185% of the poverty income levels. Proof of income is required to receive WIC benefits. No allowances for extenuating circumstances can be made. Total household income (gross) must be used; except for self-employed persons, such as a farmer or a small business owner. For this special group use gross income less business expenses. Household consists of a group of related or non-related individuals who are not residents of an institution but who are living as one economic unit.

HH: For a pregnant woman and/or child 0-19, to be financially eligible for package A and B Hoosier Healthwise, the gross economic unit income must be less than or equal to 150% of the federal poverty income. Children 0-19 are eligible for Package C (required variable premium payment) up to 200% of federal poverty income guidelines.

NOTE: CSHCS defines a pregnant woman as one family member. MCH and WIC define a pregnant woman as two family members.

HOUSE HOLD SIZE:	100% ANNUAL Income Starting At	HH A & B 150% ANNUAL Income Equal To Or Less Than	HH Partial Premium Package C 175% ANNUAL Income Equal To Or Less Than	USDA / WIC Standard 185% ANNUAL Income Equal To Or Less Than	HH Full Premium Package C 200% ANNUAL Income Equal To Or Less Than	CSHCS 250% ANNUAL Income Equal To Or Less Than
Size	**100%**	**150%**	**175%**	**185%**	**200%**	**250%**
1	**$9,570**	**$14,355**	**$16,748**	**$17,705**	**$19,140**	**$23,925**
2	**$12,830**	**$19,245**	**$22,453**	**$23,736**	**$25,660**	**$32,075**
3	**$16,090**	**$24,135**	**$28,158**	**$29,767**	**$32,180**	**$40,225**
4	**$19,350**	**$29,025**	**$33,863**	**$35,798**	**$38,700**	**$48,375**
5	**$22,610**	**$33,915**	**$39,568**	**$41,829**	**$45,220**	**$56,525**
6	**$25,870**	**$38,805**	**$45,273**	**$47,860**	**$51,740**	**$64,675**
7	**$29,130**	**$43,695**	**$50,978**	**$53,891**	**$58,260**	**$72,825**
8	**$32,390**	**$48,585**	**$56,683**	**$59,922**	**$64,780**	**$80,975**
9	**$35,650**	**$53,475**	**$62,388**	**$65,953**	**$71,300**	**$89,125**
10	**$38,910**	**$58,365**	**$68,093**	**$71,984**	**$77,820**	**$97,275**
11	**$42,170**	**$63,255**	**$73,798**	**$78,015**	**$84,340**	**$105,425**
12	**$45,430**	**$68,145**	**$79,503**	**$84,046**	**$90,860**	**$113,575**
Each additional member add	**+ $3,260**	**+ $4,890**	**+ $5,705**	**+ $6,031**	**+ $6,520**	**+ $8,150**
***MCH**	**<100%**	**101%-150%**	**151%**	**to 185%**	**186% - 200%**	**201% - 250%**
	0%	****1 – 25%**	**25%**	**to 50%**	**50%**	**75%**

Base Poverty Level is: $798. Federal Register Vol. 70, No. 33, February 18, 2005
***MCH Percentage used to calculate MCH charges. If income is greater than 250%, charge 100%.**
****Clinic choice 1-24% for the cost of service except those covered by HH.**

DEPARTMENT OF STATE REVENUE

04970118.LOF

LETTER OF FINDINGS: 97-0118
Indiana Gross Retail Tax
For Tax Periods 1993 through 1995

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Retail Tax—Uncollectible Receivables ("Bad Debt") Deduction

Authority: IC 6-2.5-6-9; Chrysler Financial Co. v. Ind. Dept. of Revenue, 761 N.E.2d 909 (Ind. Tax Ct. 2002)

Taxpayer maintains it is entitled to a refund of sales tax paid on credit card transactions later found to be uncollectible.

II. Consumer Use Tax—Store Signage & Point-of-Sale Advertising

Authority: IC 6-2.5-3-2

Taxpayer protests a portion of the use tax assessments that were based on Taxpayer's use of store signage and point-of-sale advertising materials in its Indiana stores.

STATEMENT OF FACTS

Taxpayer operates a nationwide chain of retail stores. A number of these stores are located in Indiana. Taxpayer also is the parent company of a bank ("Bank"), a wholly owned subsidiary, which issues Taxpayer's proprietary credit cards.

Pursuant to a sales and use tax audit, the Indiana Department of State Revenue ("Department") proposed additional assessments of sales and use tax. Taxpayer has protested two of these assessments.

DISCUSSION

I. Gross Retail Tax—Uncollectible Receivables ("Bad Debt") Deduction

In addition to its retail activities, Taxpayer is the parent company of a national bank ("Bank"), a wholly owned subsidiary. The Bank issues Taxpayer's proprietary credit cards ("credit cards") to Taxpayer's customers ("customers"). Customers use these credit cards to purchase merchandise at Taxpayer's retail stores. Taxpayer describes its credit sales transactions as follows:

> Simultaneously with the exchange of merchandise between [Taxpayer] and the customer, [Bank] pays [Taxpayer] for all amounts due as a result of the sale. [Taxpayer] collects sales tax on these purchases…and…remits the tax to the Indiana Department of Revenue (Department). … A small percentage of these credit card receivables go uncollected and are written off by [Taxpayer] and taken as a deduction on [Taxpayer's] federal income tax return. [Taxpayer] has an agreement with [Bank] to accept [Bank] issued credit cards and [Taxpayer] also has an ongoing agreement with [Bank] allowing [Taxpayer] to take the bad debt write off amounts as a deduction on [Taxpayer's] Indiana sales tax returns for the above periods.

Audit disallowed the bad debt deduction taken by Taxpayer because the credit card receivables were assets of the Bank and not those of Taxpayer. According to Audit, since Taxpayer assigned its credit card receivables (non-recourse) to the Bank, it is the Bank, and not Taxpayer, that may qualify for a bad debt deduction for federal income tax purposes. Consequently, it is the Bank, and not Taxpayer, that may qualify for the bad debt deduction for Indiana sales tax purposes.

Taxpayer disagrees. Taxpayer contends the assignment of its credit card receivables to the Bank (and the derivative right to the bad debt deduction provided by IC 6-2.5-6-9) should not be a factor in determining which entity is entitled to the bad debt deduction. Taxpayer explains:

> Whether the bad debt is assigned to one party or the other in this case is irrelevant in determining the validity of the deductions since the retailer [Taxpayer] and the retailer's affiliated bank [Bank] file a consolidated federal income tax return and the bad debt is taken as a deduction on that consolidated return.

Analysis

The statute entitling a retail merchant to a sales tax deduction for uncollectible receivables (bad debt) provides:

> In determining the amount of state gross retail and use taxes which [] must [be] remit[ted]…a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which: (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser; (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and (3) were written off as an uncollectible debt for federal tax purposes during the particular reporting period.
>
> IC 6-2.5-6-9(a).

Indiana case law has extended the reach of IC 6-2.5-6-9 (the "Indiana bad debt deduction"). In addition to retail merchants, assignees also may qualify for this deduction. In Chrysler Financial Co. v. Ind. Dept. of Revenue, 761 N.E.2d 909 (Ind. Tax Ct. 2002), the Indiana Tax Court found that when a retail merchant assigns without recourse an installment contract to a financial institution, the financial institution—as assignee—is entitled to claim the derivative Indiana bad debt deduction.

Taxpayer asks the Department to extend the reach of the bad debt deduction further. Taxpayer insists that once an assigned account receivable has "ripened" into a bad debt for federal income taxpayers, the original assignee (Bank) may re-assign its right to the Indiana bad debt deduction to a related third party—in this instance, to the original assignor (Taxpayer). Taxpayer is mistaken. The original assignee (Bank) may not re-assign its rights to the Indiana bad debt deduction to third parties—related or otherwise.

The assignment of credit card receivables without recourse must be distinguished from the assignment of an Indiana bad debt deduction. In Chrysler, Indiana Chrysler Dealers (Dealers) assigned without recourse "all rights, title, and interest" in their consumer installment contracts to Chrysler Financial (Chrysler). Chrysler at 911. "As consideration for the assignment, Chrysler paid the Dealers all amounts due under the contracts, including the sales tax." Id. At the time of assignment, no bad debt for federal income tax purposes existed; consequently, neither the assignor nor assignee could have claimed or taken an Indiana bad debt deduction. The Dealers did not assign a bad debt. The Dealers did not assign a bad debt deduction. Rather, the Dealers assigned installment contracts. The Dealers assigned "all rights, title, and interest in the contracts without recourse" to Chrysler. Id. Among the rights assigned included the conditional right to an Indiana bad debt deduction.

In effect, Taxpayer argues the Indiana legislature, in drafting IC 6-2.5-6-9, intended to create a transferable refundable "bad debt" sales tax credit. Again, Taxpayer is mistaken.

According to IC 6-2.5-6-9, the amount that may be deducted as bad debt for Indiana sales tax purposes is limited to the amount of receivables "written off as [] uncollectible debt for federal [income] tax purposes…." IC 6-2.5-6-9(a)(3). The latter is a condition precedent to the former.

In Chrysler, the Indiana Tax Court found that a Dealer may assign its rights to the bad debt deduction. Chrysler at 913. However, from the Court's perspective, Chrysler's right (as assignee) to the bad debt deduction was dependent upon the Dealers' prior assignment of installment contracts to Chrysler. See Chrysler at 913, FN 9. That is, the right to the bad debt deduction *derived from* the assignment of the installment sales contracts. Without the latter, there could be no former.

Taxpayer attempts to detach the realization of bad debt for federal income tax purposes from the recognition of bad debt for Indiana sales tax purposes. This contravenes the language of IC 6-2.5-6-9. Taxpayer attempts to divorce the Indiana sales tax bad debt deduction from the debt instrument itself. This extension of the Tax Court's Chrysler holding is inconsistent with the Tax Court's reasoning. Indiana tax law sanctions neither proposition.

FINDING

For the aforementioned reasons, Taxpayer's protest is denied.

II. Consumer Use Tax—Store Signage & Point-of-Sale Advertising

Taxpayer purchased store signage and Point-of-Sale ("POS") advertising materials. These items were used in Taxpayer's stores nationwide—including Taxpayer's Indiana stores. Taxpayer paid neither sales nor use tax on many of these items. Consequently, the Audit Division of the Indiana Department of State Revenue ("Audit"), pursuant to IC 6-2.5-3-2, proposed additional assessments of consumer use tax ("use tax").

Due to the number of items involved, Audit used a sampling method to compute the additional assessments. Initially, Audit determined an error percentage from which an estimate of the taxable purchases per store (nationwide) was computed. Audit then multiplied this estimated amount per store by the number of Taxpayer's stores located in Indiana. This product represented the taxable value of store signage and POS advertising materials used in Indiana ("Total Value"). Audit computed the use tax due by multiplying the Total Value by the applicable use tax rate (.05).

Taxpayer agrees with the sampling method used by Audit. However, Taxpayer disagrees with a small portion of the use tax assessments proposed by Audit. Taxpayer explains:

> This protest is due to a computation error in calculating the use tax due of POS signage. The number of stores located in Indiana at each year was overstated.

Taxpayer has provided evidence showing that several of its Indiana stores ceased doing business during the audit period. However, the ***Indiana*** use tax assessments at issue were based on an estimate of the taxable purchases per store ***nationwide***. A decrease in the number of Taxpayer's ***Indiana*** stores does not, without more, lead to the conclusion that the proposed Indiana use tax assessments were overstated. If Taxpayer also experienced a proportional decrease in the number of stores ***nationwide***, the Indiana use tax assessments at issue would remain unchanged.

Taxpayer has failed to provide the Department with sufficient information for the Department to revisit the taxable-purchases-per-store calculus and the resultant Indiana use tax assessments.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01980154.LOF
0220000275.LOF
04980091.LOF

LETTER OF FINDINGS NUMBER: 98-0091, 98-0154, 00-0275
Individual Income Tax
For the Years 1994 and 1995
Corporate Income Tax
For the Years 1991, 1992, 1993, 1994, and 1995
Sales and Use Tax
For the Years 1994, 1995, and 1996

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.

ISSUE

I. **Sales and Use Tax—Sales to out-of-state residents who picked up the merchandise in Indiana**

Authority: IC 6-8.1-5-1(b); IC 6-2.5-2-1; IC 6-2.5-9-3; 45 IAC 2.2-5-54.

Taxpayer protests the assessment of sales tax on sales made to Kentucky customers who picked up the merchandise at Taxpayer's Indiana location.

II. Sales and Use Tax—Unreported cash sales unsubstantiated by records

Authority: IC 6-8.1-5-1(b); IC 6-8.1-5-4; IC 6-8.1-5-1(a).

Taxpayer protests the assessment of sales tax due on unreported cash sales and the Department's calculation of that amount of sales tax due.

III. Corporate Income Tax—Unreported Cash Sales

Authority: IC 6-3-4-1(3); 45 IAC 3.1-1-67.

Taxpayer protests the assessment of additional income based on unreported cash sales.

IV. Individual Income Tax—Unreported Cash Sales

Authority: IC 6-3-4-1(1).

Taxpayer protests the over-recognition of pass-through income from S-corporation.

STATEMENT OF FACTS

Taxpayer operates a retail store in Indiana. Sales are made over-the-counter, by delivery, and by shipment in interstate commerce using UPS. Some Kentucky customers bought and picked up merchandise at Taxpayer's Indiana retail store. Taxpayer had registered with Kentucky as a retail merchant and was collecting and remitting sales tax to Kentucky on these Kentucky customers. The Department assessed Indiana sales tax on these sales. Taxpayer insisted these sales were exempt as sales in interstate commerce.

Taxpayer sold merchandise across-the-counter at its Indiana retail store. These are termed "cash sales." The sales were recorded on hand-written sales tickets that were not pre-numbered. These sales were rung on the cash register—which kept a tape. At the end of the day, the sales were zeroed out. Taxpayer kept the revenues in a safe and made bank deposits on a sporadic basis—varying from weekly to monthly to quarterly. The deposits were not the true amount of revenues generated by sales because Taxpayer made payouts from the register and spent money from the safe. This fact was stated by a former bookkeeper employed by Taxpayer. Taxpayer had destroyed the hand-written sales tickets and the cash register tapes for the audit period, possibly by shredding the records. The Department estimated sales by taking an average of sales made during a two-month post-assessment sample period. Taxpayer knew an active sample was being conducted—yet the hand-written sales tickets and register tapes for the sample were destroyed. The Department, using the summary tape from the register, calculated the average sales amount to be $17.57. The Department then multiplied this average by the number of sales tickets that had been used. Taxpayer had purchased a supply of sales tickets from a local printer. The Department subtracted 600 special order sales tickets it already had reviewed. Taxpayer is protesting the Department's calculation of the number of sale tickets used. Taxpayer has agreed to the average sale amount of $17.57.

The assessment of additional sales tax due triggered an increase in the amount of revenue generated by Taxpayer's business. The Department adjusted Taxpayer's corporate income tax return and Taxpayer's individual income tax return.

I. **Sales and Use Tax—Sales to out-of-state residents who picked up the merchandise in Indiana**

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-2.5-2-1 imposes a sales tax on retail transactions made in Indiana. A person who acquires property in a retail transaction conducted in Indiana is liable for the sales tax and is required to pay it to the retail merchant. *Id*. The retail merchant is required to collect the tax as an agent for the state. *Id*. If a retail merchant fails to collect or remit sales tax, the merchant and/or the responsible officers personally are liable to pay the sales tax it had a duty to collect. IC 6-2.5-9-3. 45 IAC 2.2-5-54 states that sales of tangible personal property delivered in Indiana to a purchaser are subject to sales tax.

Taxpayer had a duty to collect and remit sales tax for over-the-counter sales made to customers from Kentucky who physically purchased and picked up their merchandise at Taxpayer's Indiana retail store. Taxpayer's contradictory arguments are not relevant. Taxpayer claimed it collected and remitted sales tax to Kentucky. Taxpayer alternatively argued that the over-the-counter sales to purchasers from Kentucky were exempt from sales tax because they were made in interstate commerce. The statutes and regulation cited above are clear—Taxpayer had a duty to collect and remit sales tax to Indiana for sales made and delivered in Indiana.

FINDING

For the reasons named above, Taxpayer's protest is denied.

II. Sales and Use Tax—Unreported cash sales unsubstantiated by records

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-8.1-5-4 affirmatively requires a taxpayer to keep books and records so that the Department can review the documents to determine the amount of a taxpayer's liability for applicable taxes. The records required to be maintained include invoices, register tapes, receipts, and canceled checks. *Id*. Taxpayer created these documents; yet it affirmatively destroyed these records. If the Department reasonably believes that a taxpayer has not reported the proper amount of tax due, IC 6-8.1-5-1(a) mandates the Department to make a proposed assessment of the amount of unpaid tax on the basis of the best information available to the Department.

Despite the fact that Taxpayer had not maintained the records to substantiate cash sales for 1994, 1995, and 1996, the auditor attempted to compensate for this by estimating sales based on a sample period. Because Taxpayer and the Department agreed on a two-month post-assessment sample period, Taxpayer was on notice that an attempt to estimate sales amounts and sales volumes was being created. Taxpayer confirmed to the Department that it would maintain records so that these calculations could be made. Yet Taxpayer chose to destroy these records. Having done so, the Department made a best estimate of the average sales amount and the number of sales with the information it had available. Taxpayer has agreed that $17.57 is the average sale amount. At issue is the number of sales. The Department based the number of sales on the number of sales tickets purchased and used. Subtracting the 600 sales that the Department could substantiate, that leaves the remainder of the sales tickets for which there has been no accounting. Taxpayer has stated that the sales tickets were used for phone messages and for other general purposes. However, this statement requires a substantiation of the number of tickets used for sales and the number not used for sales. Barring positive evidence to rebut the use of the sales tickets for purposes other than sales, the Department's computation of the number of sales tickets used is the best information available to the Department.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

III. Corporate Income Tax—Unreported Cash Sales

DISCUSSION

The assessment of additional sales tax due based on the calculation of unreported cash sales triggers an increase in the revenues earned by Taxpayer. Taxpayer's business is incorporated as an S-corporation. IC 6-3-4-1(3) requires all corporations with gross income from an Indiana source to file an income tax return. 45 IAC 3.1-1-67 requires an S-corporation to file an IT-20S. Annual returns must be filed by S-corporations incorporated in Indiana or having income from Indiana sources. *Id*. Since the Department assessed unreported cash sales and since the Department upheld the sales tax assessment on those sales, the revenue is reportable for corporate income tax purposes.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

IV. Individual Income Tax—Unreported Cash Sales

DISCUSSION

Income earned by an S-corporation is passed through to the shareholders to be taxed on their individual income tax returns. Taxpayer's business is incorporated as an S-corporation, which means that the income earned by an S-corporation is considered to be income earned by the shareholders. IC 6-3-4-1(1) requires each Indiana resident to file an annual individual income tax return. Since the Department assessed unreported cash sales and since the Department upheld the sales tax assessment on those sales, the revenue is reportable for individual income tax purposes.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990617.LOF

LETTER OF FINDINGS NUMBER: 99-0617
SALES TAX
For Years 1996, 1997, and 1998

NOTICE: Under Ind. Code § 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.

ISSUE

I. Sales and Use Tax—Assessment of Use Tax on Lump-sum contracts

Authority: IC 6-8.1-5-1(b); IC 6-8.1-5-4; IC 6-8.1-5-1(a).

Taxpayer protests the 75% proportioning of sales to Indiana sources.

STATEMENT OF FACTS

Taxpayer does landscape architecture, then installs the plant and construction materials. Taxpayer provided no sales invoices or journals to the Department. Until April 1999, Taxpayer was not registered to collect Indiana sales tax. Since Taxpayer is a landscaper/contractor who failed to provide documentation, the auditor for the Department took the position that Taxpayer billed on a lump-sum basis. Billing on a lump sum basis would not have required Taxpayer to collect sales tax from the customer.

Accepting this required that use tax be determined and assessed on the materials provided to the customer. No purchase invoices were available, so the Department conducted a corporate income tax audit and determined Indiana gross receipts to be 75% of Taxpayer's revenues. Thus, 75% of the cost of goods sold were portioned to Indiana as taxable purchases. The cost of goods calculation did not include labor.

Taxpayer protested the assessment proportioning and filed a protest. The Department attempted to contact Taxpayer by mail for over one year to resolve the file, but all mail sent to Taxpayer was returned as undeliverable. Two separate addresses were used in an attempt to correspond with Taxpayer. The Department undertook a simple query of telephone listings of Taxpayer's name in an attempt to find a current address, but Taxpayer's name was not listed. This Letter of Finding was written based on the information available in the file.

I. Sales and Use Tax—Assessment of Use Tax on Lump-sum contracts

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-8.1-5-4 affirmatively requires a taxpayer to keep books and records so that the Department can review the documents to determine the amount of a taxpayer's liability for applicable taxes. The records required to be maintained include invoices, register tapes, receipts, and canceled checks. *Id*. Documentation was not made available to the Department. If the Department reasonably believes that a taxpayer has not reported the proper amount of tax due, IC 6-8.1-5-1(a) mandates the Department to make a proposed assessment of the amount of unpaid tax on the basis of the best information available to the Department.

Because of the nature of Taxpayer's business, the Department determined that the lump-sum contract method best represents the information needed to determine Taxpayer's tax liabilities. As well, the Department proportioned the Indiana contracts based on Taxpayer's corporate income tax return. Taxpayer did not present any documentation to rebut the Department's assessment; therefore, the assessment stands as determined.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010247.LOF

LETTER OF FINDINGS NUMBER: 01-0247
Sales and Withholding Tax
Responsible Officer
For the Tax Period 1993-2003

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.

ISSUE

1. Sales and Withholding Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-8.1-5-1(b), IC 6-3-4-8(f).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate sales and withholding taxes.

STATEMENT OF FACTS

The taxpayer was an officer of a corporation that did not properly remit sales taxes and withholding taxes to the state during the tax period 1993-2003. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed the unpaid sales taxes, withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax and Withholding Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

An individual who:

(1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and

(2) has a duty to remit state gross retail or use taxes to the department;

holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state.

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

The taxpayer contended that he discovered two mistakes with the department's assessments. The taxpayer provided substantial documentation to support this contention. First, the taxpayer showed that the sales tax liability for one month had actually been paid. Another month's tax liability was actually listed under two liability numbers. Since each month's tax liability need only be paid once, the duplicate liability must be deleted from the total assessment.

The taxpayer agrees that he was a responsible officer from the time the corporation was formed until the time he resigned his office and sold his interest in the corporation. The taxpayer provided substantial documentation that he did actually completely sever himself from association with the corporation on August 9, 1997. Therefore, he is not responsible for any liabilities due after August 9, 1997.

FINDING

The taxpayer's protest is sustained as to the duplicated liability, the paid liability and the liabilities due after August 9, 1997. The taxpayer owes the remainder of the assessment, interest, and penalty.

DEPARTMENT OF STATE REVENUE

0420030084.LOF

LETTER OF FINDINGS NUMBERS: 03-0084
Gross Retail and Use Taxes
For 2001

NOTICE: Under Ind. Code § 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.

ISSUE

I. Gross Retail and Use Taxes—Tractor

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-7; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4

Taxpayers protest the proposed assessment of Indiana use tax on the purchase of a John Deere tractor, which they returned to the dealer approximately three months after purchase. They received back all but $250.00 of the purchase price.

STATEMENT OF FACTS

Taxpayers own two adjacent parcels of land totaling approximately 200-plus acres. The family home and taxpayers' operated convenience store are located on the land; taxpayers farm the remainder. A use tax issue arose during the audit when the auditor declined to accept the evidence supplied showing that taxpayers had returned a John Deere tractor to the dealership approximately three months after purchase, and received all but $250.00 back in a refund. Additional facts will be added as necessary.

I. Gross Retail and Use Taxes—Tractor

DISCUSSION

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made."

Pursuant to IC § 6-2.5-2-1, a "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." *See also*, 45 IAC 2.2-2-1. Pursuant to IC §§ 6-2.5-3-1 through 6-2.5-3-7, an "excise tax, known as the use tax, if imposed on the storage, use, or consumption of tangible personal property in Indiana is the property was acquired in a retail transaction." An exemption is provided in IC § 6-2.5-3-4 if "the property was acquired in a retail transaction and the state gross retail tax" was paid at the time of purchase. Taxpayers are personally liable for the tax. (IC § 6-2.5-3-6). IC § 6-2.5-3-7 provides that a "person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana;" therefore, the presumption of taxability exists until rebutted. *See also*, 45 IAC 2.2-3-4.

The Department has revisited the use tax assessment on a John Deere tractor taxpayer returned to the dealership approximately three months after purchase, where taxpayer received all but $250.00 in a refund. The auditor decided the evidence was insufficient, especially because taxpayers did not receive a full refund. However, since a companion Letter of Findings has concluded that taxpayers agricultural activities entitled them to deduct losses because they were engaged in the business of farming, any use of the tractor for taxpayers' farming activities would render the purchase and use of the tractor exempt. There is nothing in the file to indicate the tractor was used for any other purposes. It is immaterial that taxpayers received less than a full refund for the tractor's return to the seller.

FINDING

Taxpayers' protest concerning the imposition of additional use tax for a tractor returned to the dealer is granted.

DEPARTMENT OF STATE REVENUE

0120030086.LOF

LETTER OF FINDINGS NUMBER: 03-0086
Adjusted Gross Income Tax
For Years 1999, 2000, 2001

NOTICE: Under Ind. Code § 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.

ISSUE

I. Adjusted Gross Income Tax—Agricultural losses

Authority: IC § 6-8.1-5-1(b); IC § 6-3-1-3.5; 45 IAC 15-5-3(8); 45 IAC 3.1-1-1 through 45 IAC 3.1-1-5 26 U.S.C. § 62; 26 U.S.C. § 165; 26 U.S.C. § 183

Taxpayers protest the denial of deductions from their adjusted gross income tax based on agricultural losses that the auditor decided were from a "hobby," not a business engaged in for profit.

STATEMENT OF FACTS

Taxpayers own two adjacent parcels of land totaling approximately 200-plus acres. The family home and taxpayers' operated convenience store are located on the land; taxpayers farm the remainder. Taxpayers suffered losses during the audit years at issue, which the auditor disallowed as deductions from taxpayers' individual income taxes. The auditor's rationale for disallowing the deductions was that taxpayers operated the farm as a "hobby." Additional facts will be added as necessary.

I. Individual Income Tax—Agricultural losses

DISCUSSION

Taxpayer protests the disallowance of deductions from adjusted gross income tax based on agricultural losses. The auditor's rationale for denying the deductions was based on the determination that taxpayers operated a "hobby" farm. In reality, the farmed acreage was devoted to the growing and selling of corn and soybeans for profit, as evidenced by documents taxpayer produced after the hearing.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made."

The standards for sustaining a claim for deductions from adjusted gross income tax because of agricultural losses can be found at IC § 6-3-1-3.5 and 45 IAC 3.1-1-1 through 45 IAC 3.1-1-1-5. IC § 6-3-1-3.5 defines individual adjusted gross income tax in terms of Section 62 of the Internal Revenue Code, "modified as follows." Section 62 begins with an individual's gross income tax "minus the following deductions." So, in order to arrive at an individual's Indiana income tax liability, the Department looks at the federal adjusted gross income (gross income minus allowable deductions) and then modifies that figure according to IC § 6-3-1-3.5(a). One of the deductions allowable under the federal scheme is losses from the sale of property (section 62(a)(3)) which references sections 161 *et seq*. Section 161 provides that "there shall be allowed as deductions the items specified in this part," i.e., Part VI. Section 165 allows deductions for losses "incurred in any transaction entered into for profit;" (165(c)(2)); section 167 allows deductions for depreciation of property used in a trade or business. Taxpayers ascribe their loss deductions as depreciation and interest, claiming that their income from their agricultural activities will rise as the depreciation and interest deductions lessen over time.

The auditor disallowed the deductions, arguing that since taxpayers operated the farm as a "hobby" and not for profit under section 165(c)(2) and section 183, taxpayers were not entitled to the deductions under Indiana's tax laws. Section 183 disallows deductions for activities not engaged in for profit. Section 183(d) creates a presumption that if income exceeds deductions for three of five consecutive years, then the activity is engaged in for profit. The auditor applied section 183(d) in order to characterize taxpayers' agricultural activities as a hobby because it showed no profit yet. It should be noted that taxpayers entered the acreage at issue into a federal conservation reserve plan, qualified, and received payments from the federal government in 1999, 2000, and 2001 for growing certain crops.

The Department finds that taxpayers have provided sufficient evidence to show that they are entitled to the deductions at issue.

FINDING

Taxpayers' protest concerning the audit's disallowance of deductions from adjusted gross income tax, based on agricultural losses, is granted.

DEPARTMENT OF STATE REVENUE

0420030097.LOF

LETTER OF FINDINGS: 03-0097
Sales and Use Tax
For 1999, 2000, and 2001

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Personal Use of Rental Vehicle – Use Tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; 45 IAC 2.2-3-15; Tax Policy Directive 8 (Jan. 2003).

Taxpayer argues that the audit erred when it assessed use tax on automobiles which were purchased for renting to its retail customers.

II. Purchase of Advertising Materials – Use Tax.

Authority: IC 6-2.5-1-1; IC 6-2.5-1-2; IC 6-2.5-3-2(a); 45 IAC 2.2-4-1.

Taxpayer states that the audit improperly assessed use tax on the purchase of advertising materials. Taxpayer claims that a portion of the original purchase price included the cost of exempt services and the cost of exempt postage.

STATEMENT OF FACTS

Taxpayer is in the business of renting automobiles on a short-term basis. Taxpayer operates its business at locations within the state and at locations outside the state. Taxpayer also operates several retail locations which sell or lease used cars and trucks.

The Department of Revenue (Department) conducted an audit review of taxpayer's business and tax records and determined that taxpayer owed additional use tax. Taxpayer disagreed with certain of the audit's conclusions and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer further explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Personal Use of Rental Vehicle – Use Tax.

Taxpayer bought automobiles intended for use in its car rental business. When taxpayer bought these vehicles, it did not pay sales tax because the vehicles were intended for use in an exempt manner. The audit found that taxpayer permitted certain of its employees to use the vehicles for personal reasons and concluded that the vehicles were being used – in part – for a non-exempt purpose. Therefore, the audit concluded that taxpayer owed use tax to the extent that the vehicles were being used for this non-exempt purpose.

Taxpayer buys cars directly from the manufacturer and keeps the cars for approximately four to six months. At the end of that time, taxpayer returns the cars to the manufacturer pursuant to the terms of the parties' "buy-back" arrangement. Depending on the particular type of rental vehicle, the cars have individually accumulated approximately 30,000 to 40,000 miles by the time the cars are eventually returned to the manufacturer.

Taxpayer admits that its employees use the vehicles for personal reasons and describes its policy of permitting employees to use the vehicles as follows: Approximately 10 to 14 of its mid-level management personnel are permitted to borrow vehicles. These employees are permitted to borrow vehicles which have not been rented by the end of the business day. The employees are allowed to keep the car until the next workday.

Taxpayer argues that employee use of the rental vehicles is minimal. Taxpayer estimates that of the 30,000 to 40,000 miles which accumulate during the average time it retains each vehicle, only about.2% of the mileage is attributable to employees' private use. It is taxpayer's contention that employee use of the vehicles does not impact its sales/use tax liability because non-exempt use of a vehicle is only permitted when the vehicle has not been rented to a paying customer by the end of each business day. In other words, allowing employees to use the vehicles does not affect the amount of sales tax taxpayer would be collecting from its paying customers.

The audit employed a method for calculating use tax liability based upon the Department's Tax Policy Directive 8 (Jan. 2003), entitled "Application of Sales and Use Tax to Demonstrator Automobiles." The Policy Directive suggests imposing use tax "at the rate to twenty (20) cents per mile times the Indiana sales tax rate." Alternatively, the Directive suggests that the "dealer may elect to report the use tax on two (2) percent of the dealer's cost of purchasing the vehicle...." Although the Directive relates to "Demonstrator Automobiles" and not to rental vehicles, taxpayer has no quarrel with the methodology chosen by the audit; taxpayer does maintain that the underlying rationale for imposing the tax is flawed.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is provided at IC 6-2.5-5-8 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."

Taxpayer is entitled to obtain its cars without paying sales tax because it is in the business of leasing automobiles. However, 45 IAC 2.2-3-15 states that use tax may be imposed under certain circumstances.

> If any person who issues an exemption certificate in respect to the state gross retail tax or use tax and thereafter makes any use of the tangible personal property covered by such certificate, or in any way consumes, stores, or sells such tangible personal property, where such use, consumption, storage or sale is in a manner which is not permitted by such exemption, such use, consumption, or storage shall become subject to the use tax (or such sale shall become subject to the gross retail tax), and such person shall become liable for the tax or gross retail tax thereon.

Taxpayer was entitled to purchase its cars without paying sales tax because it bought the cars for use in its auto rental business. However, to the extent that taxpayer permitted its employees to use the cars in a non-exempt (non-rental) manner, taxpayer became subject to use tax measured by the extent of that non-exempt use. The Department accepts taxpayer's contention that its policy of allowing employees occasional use of the rental car does not affect the amount of sales tax it collects from its paying customers. However, the Department is unable to accept the corollary argument that the state's gross retail tax is calculated by balancing the equities between potential sales and potential use tax liability. Taxpayer's sales tax liability is based upon its "sales" which consists of the amount of money taxpayer receives when it rents its vehicles. The amount of sales tax liability will vary from vehicle to vehicle and from month to month, but sales tax is not measured by the way in which the car is used or by the value of the particular vehicle. On the other hand, the state's use tax is measured by the way in which the car is "used" by the purchaser. If the vehicle is used in an exempt manner, there is no taxable use. If the vehicle is used in a non-exempt manner, then use tax liability accrues. Although the scenario is not likely, taxpayer could purchase a $30,000 car for its business, never succeed in renting the vehicle, never collect sales tax from a single customer, and never use the vehicle in a non-exempt fashion. If there were no sales (rentals) and no non-exempt use, there would be no sale or use tax liability; the state could not – in a subsequent audit – afterwards claim that it had to collect either sales or use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Purchase of Advertising Materials – Use Tax.

Taxpayer hired an out-of-state company to prepare and mail advertising materials to a listing of customers provided by taxpayer. The out-of-state company originally invoiced taxpayer a single charge for the cost of each order of completed and delivered materials. The audit found that taxpayer owed use tax based upon the price it paid for these materials. Taxpayer has subsequently provided information prepared by the out-of-state company detailing the costs involved in the preparation and delivery of the advertising materials. Those detailed costs specify the price charged for materials, labor, and postage. Taxpayer's contends that it only owes use tax on the price of the materials and that the amount of use tax should be reduced.

IC 6-2.5-3-2(a) states that "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 the transaction."

In effect, the audit found that taxpayer's purchase of advertising materials constituted a "unitary transaction" under 45 IAC 2.2-4-1. This regulation states as follow:

(a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant."

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

(1) The price arrived at between purchaser and seller.

(2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.

(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to the transfer of such property at retail.

The regulation derives from IC 6-2.5-1-1 which states that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." A "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in his ordinary course of business and then sells that property along with services as a unitary transaction. IC 6-2.5-1-2.

The audit was correct in concluding that taxpayer bought the advertising materials by means of a unitary transaction. There is no evidence that taxpayer negotiated for or purchased the out-of-state company's labor or delivery services separately from the cost of the materials. Taxpayer wanted advertising materials, taxpayer bought advertising materials, and taxpayer paid for advertising materials. The fact that the supplier can now supply detailed information breaking down the original invoice charges does not affect the nature or taxability of the original transaction. Taxpayer did not negotiate or pay for the supplier's services; it did not negotiate or pay for postage stamps. Taxpayer bought advertising materials in a series of unitary transactions, and it owes use tax on those unitary transactions.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02-20030114.LOF
02-20030115.LOF
02-20030130.LOF

LETTER OF FINDINGS NUMBERS: 03-0114, 03-0115, 03-0130
Gross Income Tax
For the Years 1999, 2000, 2001

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.

ISSUE

I. Gross Income Tax-Imposition

Authority: IC 6-8.1-5-1(b), IC 6-2.1-2-2, 45 IAC 1.1-6-2, *First National Leasing and Financial Corp. v. Indiana Department of Revenue*, 598 N.E.2d 640, (Ind. Tax 1992).

The taxpayer protests the imposition of gross income tax on income from certain leases.

STATEMENT OF FACTS

Taxpayer is a business engaged in the leasing of computer hardware and other technological equipment. Taxpayer's offices are located in another state, and Taxpayer does not maintain an office or personnel in Indiana. The property that Taxpayer leases is subject to a security interest in the state in which it is located and notification in the event it is moved to another state; however, Taxpayer does not control the location of the property with very minor exceptions. As a result of Department audit, Taxpayer was assessed gross income tax with respect to its income from leases located in Indiana. Taxpayer protested the assessment, and this Letter of Findings results.

I. Gross Income Tax-Imposition

DISCUSSION

All tax assessments are presumed to be accurate and taxpayers bear the burden of proving that any assessment is incorrect. IC 6-8.1-5-1(b).

Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana" of a nonresident taxpayer. IC 6-2.1-2-2. The Department assessed gross income tax on the taxpayer's income from leases of computers and technological equipment in Indiana. Taxpayer contended that its lease income was not derived from an Indiana source and therefore not subject to the Indiana gross income tax. The issue to be determined in this case is whether Taxpayer's lease income was actually derived from an Indiana source and was therefore subject to the Indiana gross income tax.

The gross income tax law concerning the taxability of income from intangibles such as the taxpayer's leases is clarified at 45 IAC 1.1-6-2 as follows:

(b) Except as provided in subsection (c), receipts derived from an intangible are included in gross income.

(c) Receipts derived from an intangible are not included in gross income under the following situations:

(1) The intangible forms an integral part of:

(A) a trade or business situated and regularly carried on at a business situs outside Indiana; or

(B) activities incident to such trade or business.

(2) The intangible does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside of Indiana.

(3) The receipts from the intangible are otherwise excluded from gross income under IC 6-2.1-1-2 or 45 IAC 1.1-3-3(c)(7).

(d) In determining whether an intangible forms an integral part of a trade or business or activities incident thereto under subsection (c) it is the connection of the intangible itself to such trade or business or activities incident thereto that is the controlling factor. The physical location of the evidence of the intangible (share of stock, bond, etc.) is not a controlling factor. Also, any activities related to the sale of an intangible occur after the fact and are never determinative.

(e) As used in this section, "commercial domicile" means the nerve center of the taxpayer where a majority of the activities and functions of the business are performed. The department will include the following types of activities in making a determination of commercial domicile.

(1) The location of management and administrative activities connected with each location, such as policy and investment decisions.

(2) The location of meetings of the board of directors.

(3) The residence of executives and their offices.

(4) The location of books and records.

(5) The location of payment on income from intangibles of the taxpayer.

(6) The information from annual and quarterly reports of the taxpayer.

The Indiana Tax Court also dealt with the issue of the gross income taxability of a nonresident taxpayer's receipts from leases in *First National Leasing and Financial Corp. v. Indiana Department of Revenue*, 598 N.E.2d 640, (Ind. Tax 1992). In that case, First National leased equipment to another corporation which used the equipment in its train derailment business. The Court set out a three part inquiry for analyzing whether or not gross income from an intangible is subject to Indiana gross income tax. First the income must be gross income. Secondly the gross income must be derived from sources within Indiana. Finally the gross income that is derived from sources within Indiana must be subject to the Indiana gross income tax. In the first step of the analysis, the Court determined that First National actually received gross income from the leases of property used in Indiana. The Court next analyzed whether the gross income was derived from activities in Indiana. The leased equipment included several mobile items such as big over-the-road trucks, tractors, lowboy trailers, pick-up trucks, cranes, miscellaneous generators, light plants, and caterpillar tractors with side booms for lifting. *Id.* at 642. That equipment was stored and used a portion of the time in Indiana. First National did not have control over the equipment nor did it know where the equipment was actually located at any particular time. All commercial activities such as negotiations and signing of documents related to the lease agreements took place outside Indiana. *Id.* at 645. The Court determined that First National's lease income was derived from sources outside of Indiana. Therefore the income was not subject to the Indiana gross income tax.

Taxpayer concedes that the lease income is gross income within Indiana's gross income tax statute, satisfying the first part of the analysis.

The taxpayer's offices, administrative personnel, administrative services, board of directors, and books and records were all outside of Indiana. The taxpayer's lease income derives from leases that were negotiated, executed, and maintained outside of Indiana.

The taxpayer contends that its lease income was identical to the non taxable income of First National. Taxpayer's argument is persuasive with respect to the property in question. The gross income received from the leases of the property in question is not derived from Indiana activities.

FINDING

The taxpayer's protest to the gross income tax is sustained.

DEPARTMENT OF STATE REVENUE

0120030243.LOF

LETTER OF FINDINGS NUMBER: 03-0243
Individual Income Tax
For the Years 1997, 1998, 1999, 2000, and 2001

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.

ISSUE

I. **Individual Income Tax—Assessment**

Authority: IC 6-8.1-5-1(b); IC 6-3-2-1(a); IC 6-3-4-1; IC 6-3-6-10; IC 6-8.1-5-1(a); IC 6-8.1-4-2(a)(6).

Taxpayer protests the assessment of Indiana individual income tax.

STATEMENT OF FACTS

Taxpayer operates a business. The Department audited Taxpayer and found that he had not filed returns. Repeated attempts were made to obtain information from Taxpayer, but none was provided. An audit was completed using the best information available. Estimates were made by projecting income, based on Taxpayer's 1996 IT-40 and his 1996 and 1997 W-2s. Taxpayer's last IT-40 return was filed for 1996. Taxpayer protested the assessment and a hearing was held.

I. **Individual Income Tax—Assessment**

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-3-2-1(a) imposes a tax each year on the adjusted gross income of every resident of Indiana. Each resident and taxpayer who has taxable Indiana income is required to file an Indiana income tax return. *See* IC 6-3-4-1. IC 6-3-6-10 requires taxpayers to keep and preserve records; these records are to be made available for inspection by the Department. If the Department reasonably believes that a person has not reported the proper amount of tax due, the Department is required to issue a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the Department. IC 6-8.1-5-1(a).

Taxpayer has been afforded ample opportunities to present coherent evidence to rebut the Department's assessment. The audit report notes that repeated attempts were made to obtain information, but none was provided. This indicates that Taxpayer chooses not to actively rebut the assessment. An auditor for the Department is granted the power to use projections and estimates in lieu of actual figures, if such figures are not available for audit examination. *See* IC 6-8.1-4-2(a)(6).

The hearing officer for the Department has actively worked with Taxpayer in an attempt to encourage and permit Taxpayer to submit documentation to rebut the assessment. The hearing originally set for October 5, 2004 was rescheduled at Taxpayer's request so that he could have the opportunity to complete the tax forms for the years in question. At the hearing on December 7, 2004, Taxpayer submitted returns for 1997, 1998, and 1999. But Taxpayer did not submit returns for 2000 and 2001. The hearing officer set the date of December 29, 2004 for the submission of the returns for 2000 and 2001. This date was mutually agreed upon by the Department and Taxpayer. Taxpayer also was asked to submit transcripts of his federal returns so that the Department could verify the income claimed. The 2000 return was received but the 2001 return still is outstanding. No copies of the federal returns were submitted. The hearing officer repeatedly has attempted to contact Taxpayer in order to resolve this assessment, but the calls have gone unanswered. Having waited one month beyond the agreed deadline, the Department now chooses to pursue Taxpayer no more. Taxpayer actively has chosen not to avail himself of the opportunity to rebut the assessment. Based on the information in the case file and the incomplete returns and documentation provided by Taxpayer, the assessment is upheld.

I. **Individual Income Tax—Assessment**

FINDING

For the reasons named above, Taxpayer's protest is denied. The assessment is upheld.

DEPARTMENT OF STATE REVENUE

02-20030277.LOF

LETTER OF FINDINGS NUMBER: 03-0277
Gross Income & Adjusted Gross Income Tax
For the Years 1998, 1999, 2000

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.

ISSUE

I. Adjusted Gross Income Tax— Intangible Holding Companies

Authority: Ind. Code § 6-3-2-2; Ind. Code § 6-3-2-2.4; Ind. Code § 6-8.1-5-1; *Chief Industries v. Ind. Dep't of Revenue*, 792 N.E.2d 972 (Ind. Tax 2000); *Bethlehem Steel Corp. v. Ind. Dept. of State Revenue*, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992); *Allied-Signal Corp. v. Director, Division of Taxation,* 504 U.S. 768 (1992); *F.W. Woolworth Co. v. Taxation and Revenue Dep't. of New Mexico,* 458 U.S. 354 (1982); *Exxon Corp. v. Dept. of Revenue of Wisconsin*, 447 U.S. 207 (1980); *Gregory v. Helvering* 293 U.S. 465 (1935); *Lee v. Commissioner of Internal Revenue*, 155 F.2d 584, 586 (2d Cir. 1998); *Horn v. Commissioner*, 968 F.2d 1229, 1236-37 (D.C. Cir. 1992); *Commissioner v. Transp. Trading and Terminal Corp.*, 176 F.2d 570, 572 (2nd Cir. 1949), *cert denied,* 338 U.S. 955 (1950); *Zebra Technologies Corp. v. Topinka*, 799 N.E.2d 725 (Ill. Ct. App. 2003); *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993).

Taxpayer maintains that the Department of Revenue erred when it recomputed taxpayer's adjusted gross income to include an affiliated company on a unitary basis.

II. Gross Income Tax—Taxability of Intangibles

Authority: Ind. Code § 6-2.1-4-6; 45 IAC 1.1-6-2.; *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993).

Taxpayer protests the assessment of gross income tax with respect to royalties paid to a related taxpayer located outside the United States.

III. Tax Administration—Penalty

Authority: 6-8.1-10-2.1; 45 IAC 15-11-2.

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

STATEMENT OF FACTS

Taxpayer is an out-of state company in the business of selling automobile supplies at retail stores throughout the United States, including Indiana. In the fiscal year ending in 1998, taxpayer transferred certain trademarks and its trade name to a wholly owned subsidiary ("Subsidiary") based in the Cayman Islands. Taxpayer in turn paid Subsidiary in exchange for the right to use the trademarks that Taxpayer previously owned, which Taxpayer then licensed to yet another subsidiary that consisted of its stores. Taxpayer had considerable property in Indiana, while Subsidiary did not maintain employees or offices in Indiana.

Department audited taxpayer's Indiana corporate income tax returns for taxable years 1998, 1999 and 2000. As a result of the audit, Department made several adjustments to the taxpayer's returns for both gross income and adjusted gross income tax purposes. For gross income tax purposes, Subsidiary was assessed gross income tax, based on the theory that the intangibles had acquired an Indiana situs, and not exempt for intracompany deduction because Subsidiary was not registered for business in Indiana. For adjusted gross income tax purposes, Taxpayer and Subsidiary were combined as a unitary filer. Taxpayer filed a protest, claiming that the Department could not constitutionally tax the intangible income either for gross income tax or for adjusted gross income tax.

I. Adjusted Gross Income Tax—Intangible Holding Companies

DISCUSSION

With respect to adjusted gross income, Taxpayer raises the issues of whether the royalty income can even be subject to Indiana adjusted gross income tax and whether the Department can require a unitary filing of two or more taxpayers in this case. In the alternative, the issues of whether the transaction is a sham transaction and if Subsidiary itself was subject to taxation on the basis of having Indiana situs must be addressed.

A. Applicability of Chief Industries

The first argument presented by Taxpayer is that the income from Subsidiary's royalties is not subject to taxation in Indiana based on the Tax Court's holding in *Chief Industries v. Ind. Dep't of Revenue*, 792 N.E.2d 972 (Ind. Tax 2000). However, it is difficult to understand Taxpayer's argument with respect to the royalties under the generally accepted statutory scheme provided by 6-3-2-2(a)-(k) - that is, whether it was business or non-business income, and whether the sales, payroll and property of the taxpayer were apportionable to Indiana in the case of business income or the income was allocable to Indiana in the case of non-business income. In this light, Taxpayer's argument does not address this issue, and accordingly must fail.

B. Sham transaction

The "sham transaction" doctrine is well established both in state and federal tax jurisprudence dating back to *Gregory v. Helvering* 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." *Commissioner v. Transp. Trading and Terminal Corp.*, 176 F.2d 570, 572 (2nd Cir. 1949), *cert denied,* 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. *Horn v. Commissioner*, 968 F.2d 1229, 1236-37 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" *Id*. at 1237.

The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. *Lee v. Commissioner of Internal Revenue*, 155 F.2d 584, 586 (2d Cir. 1998). The taxpayer has the burden of demonstrating that the subject transaction was entered into for a legitimate business purpose. Ind. Code § 6-8.1-5-1(b).

Here, it is difficult if not impossible to ascertain a business purpose for the arrangement between Taxpayer and Subsidiary. Taxpayer transferred the intellectual property that it created to Subsidiary, which licenses that property only to Taxpayer. Miraculously, Taxpayer had only a relatively modest profit from its operations of auto part retailers, but Subsidiary generated substantial profits from licensing some names and logos to nobody but their prior owner, and maintained only a small office on a Caribbean island. The shareholders of Taxpayer looked at the bottom line and saw no overall difference in the companies' operating performance. To state that Taxpayer's names and logos derived a value separate from its underlying business comports neither with reality nor common sense.

By permitting Taxpayer the deduction it claimed for adjusted gross income tax purposes is to exact a violence on the term "fairly allocate," per Ind. Code § 6-3-2-2(l) that can only be corrected by reallocating the income between Taxpayer and Subsidiary. Accordingly, the deduction for the payment to Subsidiary-the sham transaction in this case-is disallowed.

Taxpayer is, of course, entitled to structure its business affairs in any manner its sees fit and to vigorously pursue any tax advantage attendant upon the management of those affairs. However, in determining the nature of a business transaction and the resultant tax consequences, the Department is required to look at "the substance rather than the form of the transaction." *Bethlehem Steel Corp. v. Ind. Dept. of State Revenue*, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992). The transfer of the intellectual property and the royalty payments were purely matters of "form" and lack any business "substance."

C. Unitary filing

The second issue to be addressed is whether Taxpayer and Subsidiary can properly be combined on a unitary return. Under Ind. Code § 6-3-2-2(l),

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (1) separate accounting;
>
> (2) the exclusion of any one (1) or more of the factors;
>
> (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

In addition, Ind. Code § 6-3-2-2(m) states:

> In the case of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the Department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

Subsidiary was a wholly owned subsidiary of Taxpayer, so common control was not at issue. Thus, the issue remains as to whether Taxpayer and Subsidiary in fact constituted a unitary business.

To look at whether a taxpayer and subsidiary comprise a unitary business, one must look at the (1) functional integration; (2) centralization of management; and (3) economies of scale. *Allied-Signal Corp. v. Director, Division of Taxation,* 504 U.S. 768, 781 (1992) *(citing F.W. Woolworth Co. v. Taxation and Revenue Dep't. of New Mexico,* 458 U.S. 354, 364 (1982)). In order to exclude certain income from the apportionment formula, the company must prove that "the income was earned in the course of activities unrelated to the sale of [property] in that State." *Exxon Corp. v. Dept. of Revenue of Wisconsin*, 447 U.S. 207, 223-224 (1980) *(citing Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980)). One "looks to the "underlying economic realities of a unitary business," and the income must derive from "unrelated business activity" which constitutes a "discrete business enterprise,"" *Mobil*, 445 U.S. at 439, 441-442.

With respect to functional integration, in *F.W. Woolworth*, the court noted that the operation of taxpayer and four foreign subsidiaries who maintained separate operations failed to constitute functional integration necessary to permit unitary taxation. 458 U.S. at 364-365. Here, Taxpayer wholly owns Subsidiary. Taxpayer paid royalties for the right to use trademarks owned by Subsidiary. Taxpayer and Subsidiary received income only when Taxpayer sold auto parts. Even with the royalty-payment transaction, nothing changed with respect to the taxpayer's overall business- Taxpayer acknowledged in Securities & Exchange Commission filings for several years that the trademarks now held by the new corporation were "important components of our merchandising and marketing strategy" before AND AFTER the formation of Subsidiary. One of two inferences can be made from this: either the names aren't so important to Taxpayer that it can allow Subsidiary to use it even to the detriment of Taxpayer, or the two companies are *de facto* one enterprise.

Further, even though the companies had some different managers, the companies had the same key executives. Accordingly, Taxpayer and Subsidiary met this requirement of unitary filing.

With respect to economies of scale, the company has not provided any evidence that the auditor's determination was incorrect. Further, with respect to any economies of scale, it would appear that Taxpayer, by virtue of not having to incur the expense of additional officer compensation and of additional costs associated with actual licensing agreements with third parties, achieved the necessary economies of scale. In the alternative, Subsidiary managed to generate several million dollars out of a single office-a ratio far greater than its revenue-to-marginal expense ratio likely found at its retail stores, achieving the necessary economies of scale.

Finally, with respect to fair representation of income, Taxpayer's transaction can only be described as not fairly representing Taxpayer's income. Taxpayer received a substantial profit from its stores' sales of automobile parts, only to have it greatly reduced by using its own name for a substantial sum of money. Both businesses, if respected as businesses, constituted an integrated enterprise, and to state that only the portion due to its primary automobile parts business was taxable, without recognizing the whole of the enterprise to overall profitability, was to not fairly represent Taxpayer's income in Indiana.

Taxpayer also noted that its subsidiary was located in a foreign country, and therefore it should be exempt under Ind. Code § 6-3-2-2(o), which provides that a foreign corporation or foreign operating company cannot be combined under subsections (l) and (m). A foreign operating company is defined by Ind. Code § 6-3-2-2.4(a) as being a company which has 80% or more of its business activity outside the United States. A business meets the criteria if its United States property factor (defined as United States property over worldwide property) and its United States payroll factor (defined as United States payroll over worldwide payroll), added together, divided by 2, is greater than or equal to 0.80. IC 6-3-2-2.4

Only one court has dealt with the situation presented by the Taxpayer and Subsidiary in this case with respect to an intangibles holding company located in a foreign country. In *Zebra Technologies Corp. v. Topinka*, 799 N.E.2d 725 (Ill. Ct. App. 2003), a company engaged in the business of manufacturing bar-coding equipment formed another corporation, incorporated in Bermuda to which it transferred its intellectual property. Taxpayer maintained that the corporation was not subject to forced unitary filing based on an Illinois statute similar to Ind. Code § 6-3-2-2(o). In particular, the taxpayer argued that the company had no payroll or property in the United States, and therefore was precluded from forced unitary filing. The court, however, noted that much of the work related to the intellectual property actually occurred in the United States, held that the company in question was not a foreign operating company, and therefore subject to unitary filing. *Id.* at 732-734.

Here Taxpayer was presented with an opportunity to address this issue during hearing and in the period after the hearing Taxpayer was presented an additional opportunity to gather information. Taxpayer has not presented information other than its statement that the Subsidiary was a foreign operating company and a note that the case cited above was not an Indiana case, without further information regarding exploitation of the intellectual property either in the United States or elsewhere. Accordingly, Taxpayer's burden to show that the company was in fact a foreign operating company has not been met.

D. Subsidiary has Indiana situs

Even if the subsidiary was not a unitary taxpayer, Subsidiary's income was Indiana source income when it engaged in transactions related to "exploiting" intellectual property.

Here, the case *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), though not controlling, is quite persuasive. In that case, a large toy company established a company to which it transferred its trademarks. The toy company paid a percentage of its sales to the trademark holding company. The trademark holding company was located in Delaware, but had no employees. *Id.* at 15, n.1. The toy company claimed a deduction for its royalty payments to the holding company for South Carolina corporate income tax purposes, but claimed that none of the royalty payments were South Carolina source income. South Carolina claimed that the holding company had conducted business in South Carolina, while the holding company claimed that taxation of its royalty income by South Carolina was prohibited by the federal constitution. The court noted that the holding company had nexus with South Carolina, via the purposeful opening of stores in South Carolina and the toy company's sales of merchandise at its South Carolina stores, through which the holding company derived its revenues. *Id.* at 16-18. Accordingly, the court held that the taxation of the holding company's income was permissible under the United States Constitution and South Carolina law.

Subsidiary was engaged of managing intellectual property-property that has no value apart from Taxpayer's sales of merchandise. To state that the intangible income derived from the licensing transactions only took place in the Cayman Islands, in an office with a telephone, fax machine, computer and some furniture, did not fairly represent the transaction between Taxpayer and Subsidiary. Taxpayer sold automobile products for a business, in this state, almost every other state, and a few foreign countries. Taxpayer derived the benefit of sales made in Indiana stores of its services and parts. To state that the royalty income was income derived only from the Cayman Islands was to very conveniently ignore that the sales and service that made the taxpayer a veritable household name occurred in many states other than the Cayman Islands (where, interestingly, Taxpayer did not even have a store), and that Subsidiary's own revenues for the royalties necessarily derived from the sales that transpired in many states and countries, rather than just the Cayman Islands.

FINDING

Taxpayer's protest is denied.

II. Gross Income Tax— Taxability of Intangibles

DISCUSSION

Taxpayer protests the imposition of gross income tax with respect to its royalty payments made to a related taxpayer located in the Cayman Islands.

In this case, three issues must be resolved:

1. Did the taxpayer have an Indiana situs for its intangibles?
2. Is the taxpayer a unitary filer?
3. Is the whole transaction a sham transaction?

With respect to situs, taxpayer argues that the intangibles formed an integral part of a trade or business situated and regularly conducted outside Indiana, noting the location of its intangibles in the Cayman Islands. Accordingly, under Department regulations, the intangible income should be attributed to that location.

However, it cannot be said that this is an entirely accurate assessment of the taxpayer's arrangement. Taxpayer's arrangement basically works in this manner: Taxpayer's store subsidiary made a sale of auto parts at its store. Taxpayer in turn took the money and paid to Subsidiary a percentage of that money for the "right" to use Taxpayer's own name. By virtue of its control of Taxpayer's name and its exploitation in Indiana, Subsidiary acquired an Indiana situs.

Taxpayer argues that the auditor's reliance on the *Geoffrey* case cited previously is misplaced, first by noting that the case was decided in another state, and second by noting the regulations stated above. While *Geoffrey* is persuasive rather than mandatory authority in Indiana, the reasoning that the intangible has situs in this circumstance is worthy of discussion. In the current case, Subsidiary only derived income upon the sale of goods at its stores. This is very similar to the intangible holding company in *Geoffrey,* which the court noted derived its income not from the mere holding of a piece of paper, but rather from retail transactions that the retailer purposely sought. Further, unlike a conventional franchise arrangement in which a holder of a name agrees to allow unrelated third parties to use its name, Subsidiary transacted business only with Taxpayer. To the extent that the subsidiary yielded its "royalties" as a result of Indiana sales, the intangible formed an integral part of a business regularly carried on in Indiana; thus, the intangibles had a business situs in Indiana, and accordingly were properly subject to Indiana gross income tax. 45 IAC 1.1-6-2. Further, because Subsidiary was not authorized to do business in Indiana, the deduction under Ind. Code § 6-2.1-4-6 for transfers between affiliated corporations filing consolidated returns was not permitted.

If Taxpayer and Subsidiary were in fact a unitary business, the same result is reached. Finally, given that no exemption or deduction exists for gross income received in a sham transaction, then the income was still taxable, notwithstanding the disregard for the transaction otherwise for tax purposes.

FINDING

Taxpayer's protest is denied.

III. Tax Administration—Penalty

DISCUSSION

Taxpayer argues that it is not subject to negligence penalties with respect to the additional taxes assessed against it. In particular, Taxpayer argues that the additional tax was due to its different, but reasonable, interpretation of the statute. Accordingly, it argues that it was not negligent in its tax returns for the years in question.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. Ind. Code § 6-8.1-10-2.1. The Indiana Administrative Code further provides:

> (b) "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.
>
> (c) 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.

45 IAC 15-11-2.

Taxpayer has acted in a manner with respect to the tax laws of this state that leads the Department to believe that its actions were a negligent disregard of those laws at best. Accordingly, the penalty must stand.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030304.LOF

LETTER OF FINDINGS NUMBER: 03-0304
Sales and Use Tax
For the Years 2000-2002

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

I. Sales and Use Tax- Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-4-10, IC 6-2.5-5-8, IC 6-2.5-8-8, 45 IAC 2.2-8-12.

The taxpayer protests the imposition of sales tax.

II. Tax Administration- Ten Percent (10%) Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is a corporation renting linens to businesses such as caterers, country clubs, and restaurants. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales tax, interest, and penalty for the tax period 2000-2002. The taxpayer protested the assessment of sales tax on its leases of linens. The taxpayer contended that its leases qualified for exemption because its customers re-leased the linens to their customers. A telephone hearing was held and this Letter of Findings results.

I. Sales and Use Tax-Imposition

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC 6-8.1-5-1 (b).

Indiana imposes a sales tax on retail sales of tangible personal property in Indiana. The sellers of the property are required to collect the sales tax from the purchasers and remit that tax to the state unless the sale qualifies for a statutory exemption. IC 6-2.5-2-1. The rental of tangible personal property is defined as a retail sale subject to the Indiana sales tax. IC 6-2.5-4-10. Sales and leases of tangible personal property to another for the purpose of selling or leasing the property in the ordinary course of business is exempt from the Indiana sales tax. IC 6-2.5-5-8.

IC 6-2.5-8-8 provides for exemption certificates from sales tax in pertinent part as follows:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

45 IAC 2.2-8-12 clarifies the law concerning exemption certificates in pertinent part as follows:

(d)Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof...

Pursuant to the statute and explanatory regulation, the production of a valid exemption certificate exempts the merchant from the duty of collecting and remitting sales tax. Without a valid exemption certificate, the burden shifts back to the merchant to prove that the sales were not actually subject to sales tax. The taxpayer provided valid exemption certificates for several of the leases on which the department assessed sales tax. The taxpayer had no duty to collect and remit sales tax on these leases.

The taxpayer had two customers who did not provide valid exemption certificates. Therefore, the taxpayer has the burden of proving that the leases to these customers were exempt from the sales tax. To establish that these leases were exempt from the sales tax, the taxpayer presented letters indicating that the customers paid use tax on the use of the linens so no sales tax would be due on the transfer. These letters are not adequate to sustain the taxpayer's burden of proving that the leases were actually exempt from sales tax.

FINDING

The taxpayer's protest to the sales tax assessed on leases to customers who provided valid exemption certificates is sustained. The remainder of the protest is denied.

II. Tax Administration- Ten Percent (10%) Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) 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 taxpayer ignored the law and department's instructions for registration with the department and the collection and remittance of Indiana sales taxes. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030358.LOF

LETTER OF FINDINGS: 03-0358
Indiana Corporate Income Tax
For the Years 1998 through 2001

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Unrelated Business Income – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2.8; IC 6-3-2-3.1; 45 IAC 1.1-3-9; 45 IAC 1.1-3-9(a); 45 IAC 3.1-1-68; I.R.C. § 511; I.R.C. § 511(a); I.R.C. § 512; I.R.C. § 512(a); I.R.C. § 513; Deer Park Country Club v. Commissioner, 70 T.C.M. (CCH) 1445 (1995); 2002 U.S. Master Tax Guide (CCH 2002).

Taxpayer argues that it is not subject to adjusted gross income tax on the money it received from the sale of its real property and equipment.

STATEMENT OF FACTS

Taxpayer is a not-for-profit organization located within the state and qualified as an I.R.C. § 501(c)(7) organization. The taxpayer's main purpose was to own, operate, and maintain a facility for the members of an associated fraternal organization which, itself, was not in a position to own the property. In 1999, taxpayer sold the building, contents, and equipment.

During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The audit resulted in an assessment of additional adjusted gross income tax. Taxpayer challenged this assessment, submitted a protest to that effect, an administrative hearing was conducted during which taxpayer further explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Unrelated Business Income – Adjusted Gross Income Tax.

The audit found that taxpayer owed adjusted gross income tax on the amount of money it received when it disposed of real and personal property in 1999. The audit did so under authority of IC 6-3-2-2.8 which states in part that "Notwithstanding any provision of IC 6-3-1 through IC 6-3-7, there shall be no tax on the adjusted gross income of the following: (1) Any organization described in Section 501(a) of the Internal Revenue Code, except that any income of such organization which is subject to income tax under the Internal Revenue Code shall be subject to the tax under IC 6-3-1 through IC 6-3-7."

The audit concluded that the income *was* subject to income tax under the Internal Revenue Code based upon the I.R.C. § 512 definition of "unrelated business taxable income." I.R.C. § 512 states that, "Except as otherwise provided in this subsection, the term 'unrelated business taxable income' means the gross income derived by any organization from an unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with carrying on of such trade or business...."

I.R.C. § 513 states that, "the term 'unrelated trade or business' means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related... to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501...."

I.R.C. § 511 imposes a federal income tax "on unrelated business income of charities" including "organizations described in sections 401(a) and 501(c)." I.R.C. § 511(a). I.R.C. § 512 states that unrelated business income consists of the gross income from any unrelated trade or business "regularly" carried on minus business deductions directly connected with the unrelated business income. I.R.C. § 512(a). To be taxable, income must be from a business not substantially related to the exercise of the charitable, educational, or other purpose on which the exemption is based. I.R.C. § 513.

Taxpayer argues that the income is not subject to the state adjusted gross income tax because only the unrelated business income as defined in I.R.C. § 513 is subject to adjusted gross income and supplemental net income tax. Taxpayer cites as authority IC 6-3-2-3.1 which states in part that, "Except as otherwise provided in subsection (b), income is not exempt from the adjusted gross income tax, or the supplemental net income tax, under section 2.8(1) of this chapter if the income is derived by the exempt organization from an unrelated trade or business as defined in Section 513 of the Internal Revenue Code." IC 6-3-2-3.1(a). *See also* 45 IAC 3.1-1-68. According to taxpayer, because the income comes within the definition found under § 512(a)(3), it is not subject to state tax under IC 6-3-2-3.1.

"Although, under Code Sec. 501, a variety of nonprofit philanthropic or mutually beneficial organizations may be granted tax-exempt status, they may become subject to tax on income from a business enterprise not related to their purpose." 2002 U.S. Master Tax Guide para. 655, p. 211 (CCH 2002). I.R.C. § 512(a) provides in relevant part as follows:

> For purposes of this title (3) Special rules applicable to organizations described in section 501(c)(7) or (9)... (D) Nonrecognition of gain... If property used directly in the performance of the exempt function of an organization described in section 501(c)(7) or (9) is sold by such organization, and within a period beginning 1 year before the date of such sale, and ending 3 years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property. For purposes of this subparagraph rules similar to the rules provided by subsections (b), (c), (e), and (j) of section 1034 shall apply.

The audit report found that "The taxpayer did not purchase other property within the 3 year time limit; therefore, they must recognize the full gain on the property sold as 'unrelated business taxable income.'" In addition, the audit report found that "the taxpayer did not set aside interest and dividends income derived from the investment of receipts from the sale of the property over the 3 year period as required under IRC 512(a)(3)(B) for determining 'exempt function income'... [therefore] it too becomes 'unrelated business taxable income' as defined under IRC § 512." The secondary reference to which the audit report refers is found at I.R.C. § 512(a)(3)(B) which defines "exempt function income" as "all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (2)), which is set aside (i) for a purpose specified in section 170(c)(4), or (ii) in the case of an organization described in paragraph (9), (17), or (3) of section 501(c) to provide for the payment of life, sick, accident or other benefits, including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii)."

In other words, the audit report found that taxpayer did not reinvest the money it earned from the sale of its property within three years and did not use the interest earned on that same money for an exempt purpose. Taxpayer does not contest either of these conclusions.

Taxpayer is correct that the term "unrelated trade or business" is defined in I.R.C. § 513. However, the term "unrelated business taxable income" is defined in I.R.C. § 512. The two sections must be read together to determine what is "unrelated trade or business" and whether income from that "unrelated trade or business" constitutes "unrelated business taxable income." I.R.C. § 511 imposes a tax on the "unrelated business income of charitable etc. organizations," I.R.C. § 513 sets out the definition of "unrelated trade or business," and I.R.C. § 512 explains how to determine the amount of "unrelated business taxable income." The income taxpayer derived was from an "unrelated trade or business" as defined under I.R.C. § 513 and becomes subject to the state's adjusted gross (and supplemental net income) tax pursuant to IC 6-3-2-3.1.

In Deer Park Country Club v. Commissioner, 70 T.C.M. (CCH) 1445 (1995), the court stated that, "The plain language of section 512(a)(3)(D) limits nonrecognition treatment to gains realized on the sale of property used directly in the performance of the organization's exempt function." The court concluded "that the plain and ordinary meaning of the phrase 'used directly in the performance of the exempt function of an organization' as set forth in section 512(a)(3)(D) connotes an exempt organization's use of assets or property that is both actual and direct in relation to the performance of its exempt function." The court concluded that the petitioner – an I.R.C. 501(c)(7) organization – was not entitled to nonrecognition treatment for the money it received when it sold a portion of its property to a housing development because the money was not used directly in the performance of the taxpayer's exempt function.

As an organization described in I.R.C. § 501(a), taxpayer was entitled to the state tax exemption provided under IC 6-3-2-2.8. However, that state exemption ended to the extent that taxpayer received income "subject to income tax under the Internal Revenue Code...." IC 6-3-2-2.8.

Nonetheless, taxpayer points out that the audit found that the income was not subject to gross income tax pursuant to 45 IAC 1.1-3-9. Taxpayer's argument is that if the income was not subject to gross income tax, that same income cannot be subject to adjusted gross income tax. The cited regulation states in relevant part that, "Except as provided in subsections (b), (c), and (e) a taxpayer organized and operated for fraternal or social purposes or as a business league or association is not subject to the gross income...." 45 IAC 1.1-3-9(a) However, the regulation also states that "The exemption provided by subsection (a) does not apply to gross income derived from an unrelated trade or business as defined in Section 513 of the Internal Revenue Code." Taxpayer is correct in pointing out that the audit's conclusion – that the income from the sale of the property *was not* subject to gross income tax pursuant to 45 IAC 1.1-3-9 but *was* subject to adjusted gross income tax – is inconsistent.

However, the answer to taxpayer's challenge is that the audit erred in concluding that the income was not subject to gross income tax. The regulation plainly stipulates that if the fraternal organization receives income from an "unrelated trade or business" as set out in I.R.C. § 513, that income is subject to the state's gross income tax. The money taxpayer received from selling real and personal property was unrelated to its fraternal purposes, falls within I.R.C. § 513, and loses the exemption set out in 45 IAC 1.1-3-9(a).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030381.LOF

LETTER OF FINDINGS: 03-0381
Indiana Corporate Income Tax
For the Years 1999, 2000, and 2001

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Resource Recovery System Credit – Gross Income Tax.

Authority: IC 6-2.1-4-3; IC 6-2.1-4-3(a); IC 6-2.1-4-3(b); IC 13-11-2-99(a); IC 13-11-2-205(a); Black's Law Dictionary (7th ed. 1999); American Heritage Dictionary (1st ed. 1969).

Taxpayer argues that the Department of Revenue erred when it disallowed taxpayer's depreciation deduction for its resource recovery system.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department of Revenue exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of manufacturing aluminum wheels. The Department of Revenue (Department) conducted a review of taxpayer's state income tax returns. That review resulted in the assessment of additional Indiana corporate income taxes. Taxpayer disagreed with the Department's conclusions reached during this initial review and with the consequent additional assessments. Accordingly, taxpayer submitted a protest to that effect, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Resource Recovery System Credit – Gross Income Tax.

Taxpayer manufactures aluminum automobile wheels. Taxpayer does so by melting aluminum ingots in its furnaces and pouring the molten aluminum into gravity molds. After the aluminum has cooled, the partially finished wheels are removed from the molds. Taxpayer then machines the partially finished wheels to remove excess aluminum. During this machining, chemical coolants are sprayed on the wheels. A certain amount of the coolant remains on the aluminum shavings. The contaminated aluminum shavings are collected by a series of conveyors and placed in bins. According to taxpayer, it cannot use the contaminated aluminum shavings until the coolant residue is removed. Because it lacks the capacity to do so itself, taxpayer sends the contaminated shavings to a third-party processor which is equipped to remove the contaminants. The third-party processor treats the aluminum shavings, taxpayer pays third-party processor a fee for this service, and the third-party processor returns the decontaminated shavings – in the form of newly cast ingots – to taxpayer. The newly formed ingots are now suitable for reintroduction into taxpayer's manufacturing process.

Taxpayer maintains that, by virtue of its manufacturing and reclamation process, it operates a "resource recovery system" (RRS). Therefore, taxpayer originally claimed a credit for its RRS against receipts subject to Indiana gross income tax equal to the amount of depreciation of the RRS taken on its federal returns.

The Department's review of taxpayer's income tax returns concluded that taxpayer was not entitled to take the credit because taxpayer's treatment of the contaminated aluminum shavings "[did] not qualify for the resource recovery credit." The Department found that any "resource recovery system" must process solid waste or hazardous waste and that the term "waste" was defined as "a worthless or useless by-product such as garbage or trash." The Department concluded that the aluminum shavings were not "waste" because the shavings had value to the taxpayer. According to the Department's initial report, "Waste does not include scrap."

Taxpayer claimed the RRS credit under the authority provided for in IC 6-2.1-4-3. The statute states in relevant part as follows:

> If for federal income tax purposes a taxpayer is allowed a depreciation deduction for a particular taxable year with respect to a RRS, and if the resource recovery system processes solid waste or hazardous waste, the taxpayer is entitled to a deduction from his gross income for that same taxable year. IC 6-2.1-4-3(b).

Therefore, in order for any taxpayer to claim the credit, that taxpayer must (1) operate a RRS, (2) the taxpayer must have been allowed a federal credit, and (3) the RRS must process "solid waste or hazardous waste."

The statute sets out the criteria under which the taxpayer may claim the credit. "'Hazardous waste' has the meaning set forth in IC 13-11-2-99(a) and includes a waste determined to be hazardous waste under IC 13-22-2-3(b)." IC 6-2.1-4-3(a).

IC 13-11-2-99(a) states that the term "hazardous waste" means:

> a solid waste or combination of solid wastes that, because of its quantity, concentration, or physical, chemical, or infectious characteristics, may: (1) cause or significantly contribute to an increase in: (A) mortality; (B) serious irreversible illness; or (C) incapacitating reversible illness; or (2) pose a substantial present or potential hazard to (A) human health; or (B) the environment; when improperly treated, stored, transported, disposed of, or otherwise managed.

In addition, the RRS statute defines "solid waste" stating that "'Solid' waste has the meaning prescribed by IC 13-11-2-205(a) but does not include dead animals or any animal solid or semisolid wastes." IC 6-2.1-4-3(a).

IC 13-11-2-205(a) states in part that "'Solid waste', for purposes of IC 13-19, IC 13-21, IC 13-20-22, and environmental management laws... means any garbage, refuse, sludge from a waste treatment plant, sludge from a water supply plant, sludge from an air pollution control facility, or other discarded material including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, or agricultural operations or from community activities."

In enacting IC 6-2.1-4-3, the Legislature limited the availability of the depreciation credit to those taxpayers which process either "hazardous waste" or "solid waste."

Taxpayer contends that the contaminated aluminum shavings are "waste" because – in their unprocessed form – they have no value to the taxpayer. According to taxpayer, the contaminated aluminum shavings have "less than no value" because the contaminated shavings represent the cost of eliminating the coolant chemicals.

The Department must disagree with the taxpayer on two grounds. Under the plain reading of the statute, both "hazardous waste" and "solid waste" constitute substances which have no intrinsic value. The definition of waste is that it constitutes "[r]efuse or superfluous material, esp[cially] that remaining after a manufacturing or chemical process." Black's Law Dictionary 1584 (7th ed. 1999). ("Any useless or worthless byproduct of a process or the like; refuse or excess material." American Heritage Dictionary 1447 (1st ed. 1969)). Therefore, in order to claim the gross income tax credit provided for under IC 6-2.1-4-3, the claimant taxpayer must have purchased and be operating a system that processes worthless, discarded materials.

The Department must also disagree with taxpayer's contention that the contaminated aluminum shavings have no value. Merely because it costs money to process the contaminated aluminum shavings does not mean that the shavings are valueless, discarded waste. Indeed, there are costs other than the expense of removing the coolant residue such as the cost of transporting the shavings to and from the third-party processor, the cost of reforming the shavings into manageable ingots, and the cost of resmelting the ingots at the time they are reintroduced into taxpayer's manufacturing process. Simply because it costs money to process and reintroduce the aluminum shavings does not mean that the shavings are valueless. Indeed, the entire point of this exercise is that the shavings do have an inherent value which justifies the expense of salvaging the raw aluminum and forming the recovered aluminum into salable wheels.

In addition to the above-noted objections, the Department must point out that it is entirely unclear as to just what it is that taxpayer is depreciating. IC 6-2.1-4-3 provides a credit for the depreciation of a RRS. However, from taxpayer's description of its manufacturing process, it is uncertain whether taxpayer has a RRS because the operation to remove the hazardous coolants is performed entirely by a third-party processor. Taxpayer appears to be operating a straight-forward manufacturing system. Other than placing the contaminated shavings into bins, it is unclear what sort of "system" it operates to reprocess these aluminum shavings.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer asks that the Department abate the ten-percent negligence penalty because in interpreting the "plain language of the resource recovery statute in taking a deduction... [it was] acting due to reasonable cause and not willful neglect."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that 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...."

During a previous audit of its 1996 and 1997 returns, taxpayer was denied the RRS credit for purposes of calculating its gross income tax. The audit did so on the ground that its system did not qualify as a RRS because the system did not process valueless waste. Nonetheless, taxpayer claimed an identical credit based upon identical grounds on its 1999, 2000, and 2001 returns. Although taxpayer and the Department may continue to disagree concerning the applicability of the RRS credit, the Department is unable to conclude that taxpayer's decision to claim a previously disallowed credit constitutes "ordinary business care."

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030422.LOF

LETTER OF FINDINGS NUMBER: 03-0422
Income Tax
For the Years 1997-2001

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 Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax-Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-2.1-2-2(a)(2), IC 6-2.1-1-2, 45 IAC 1-1-51, 45 IAC 1.1-6-2.

The taxpayer protests the imposition of gross income tax.

II. Adjusted Gross Income Tax-Imposition

Authority: IC 6-3-2-1, IC 6-3-2-2(a), 45 IAC 3.1-1-55.

The taxpayer protests the imposition of adjusted gross income tax.

III. Tax Administration-Ten Percent (10%) Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is a Delaware holding company. The taxpayer corporation receives its income from the licensing of its intellectual property and trademarks to affiliated companies that use the intellectual property in several states including Indiana. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax, interest, and penalty. The taxpayer protested the imposition of the tax and ten percent (10%) negligence penalty. A hearing was held. This Letter of Findings results.

I. Gross Income Tax-Imposition

DISCUSSION

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).

The taxpayer's first protest concerns the department's imposition of gross income tax on its income from Indiana. Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). For purposes of the gross income tax, "gross income" includes receipts from "the investment of capital, including interest, discounts, rentals, royalties, dividends, fees, and commissions." IC 6-2.1-1-2.

Under the regulations governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51(1997 and 1998) 45 IAC 1.1-6-2 (1999-2001). The term "intangibles" includes:

> Notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, lease royalties, certificates of sales, choses in action, *and any and all other evidences of similar rights capable of being transferred, acquired or sold. (Emphasis added).* Id.

In order for Indiana to impose the gross income tax on income derived from the Delaware holding company's intangibles, the department must determine that the income is derived from a "business situs" within the state. Id. The regulation states that a taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana...."Id. Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." Id.

Clearly the taxpayer's gross income, the licensing fees received from its affiliated corporation, is income derived from a "business situs" in Indiana. The taxpayer's intellectual property is licensed to the Indiana affiliated corporation. The intellectual property is "localized" in Indiana in the sense that the affiliated corporation uses the intellectual property to increase the value of the products the affiliated corporation sells in Indiana at the affiliated corporations sales outlets and distribution centers. But for the sales by the affiliated corporation in Indiana, the taxpayer would not receive the income.

The taxpayer's intellectual property has acquired a business situs within Indiana. The income at issue is connected with that business as contemplated by the Indiana statute imposing the gross income tax. Therefore, the department properly imposed the gross income tax on the taxpayer's licensing fees.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Imposition

DISCUSSION

The taxpayer also protests the imposition of the adjusted gross income tax.

Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC 6-3-2-1. The legislature has defined "adjusted gross income at IC 6-3-2-2(a) as follows:

> (1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

The taxpayer and the department agree that the taxpayer receives income from the licensing of its intellectual property, trademarks, from its affiliated corporation in Indiana. The issue is whether or not this income is derived from a source within Indiana so it is subject to the adjusted gross income tax. This issue is clarified by 45 IAC 3.1-1-55 as follows:

> The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

The taxpayer licenses the intellectual property for use by its affiliated companies, deriving value from the ability to place the trademarks at retail locations in various states. The value attaches to the trademarks solely upon use at those retail and distribution locations including those in Indiana. Apart from the use in those locations, the trademarks would have no significant value. There would be no payments or income received by the taxpayer if the trademarks were not attached to products sold in Indiana locations. The income is inextricably connected with the affiliated corporation's retail outlets and distribution centers in Indiana. This constitutes a "business situs" subjecting the subject income to the Indiana adjusted gross income tax.

FINDING

The taxpayer's protest is denied.

III. Tax Administration- Ten Percent (10%) Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) 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 reach 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 taxpayer disregarded its duty to file an Indiana corporate income tax return. This breach of the taxpayer's duty constituted negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320040040.LOF

LETTER OF FINDINGS NUMBER: 04-0040
Withholding Tax
Responsible Officer
For the Tax Period 1998

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.

ISSUE

1. Withholding Tax-Responsible Officer Liability

Authority: IC 6-3-4-8(f), IC 6-8.1-5-1(b).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate withholding taxes.

STATEMENT OF FACTS

The taxpayer was a shareholder in a corporation that did not properly remit withholding taxes to the state during the tax period 1998. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed the unpaid withholding taxes, interest, and penalty against the taxpayer. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

The taxpayer admits that he was one of three persons responsible for the remittance of the subject withholding taxes to the state. The taxpayer contends, however, that he fulfilled his responsibility by giving another of the responsible parties a check for one third of the taxes due. That party failed to satisfy the liability with the state.

The statute clearly states that every responsible person is responsible for the payment of the entire amount of the tax due to the state. There is no statutory exemption granted for persons who gave another person money that was never remitted to the state.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040060.LOF

LETTER OF FINDINGS NUMBER: 04-0060
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for six million, four hundred thousand dollars ($6,400,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320040066.LOF

LETTER OF FINDINGS NUMBER: 04-0066
Withholding Tax
Responsible Officer
For the Tax Period 1999-2001

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.

ISSUE

1. Withholding Tax-Responsible Officer Liability

Authority: IC 6-8.1-5-1(b), IC 6-3-4-8(f), Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate withholding taxes.

STATEMENT OF FACTS

The taxpayer was the President of a corporation that did not properly remit withholding taxes to the state during the tax period 1999-2001. The Indiana Department of Revenue assessed the unpaid sales taxes, withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995) any officer, employee, or other person who has the authority to see that they are paid has the statutory duty to remit withholding taxes to the state. As the President of the corporation, the taxpayer had the responsibility to oversee the corporation. The taxpayer failed to insure that the corporation fulfilled its financial responsibilities by remitting trust taxes to the Indiana Department of Revenue. The taxpayer had the statutory duty to remit the sales and withholding taxes due during his term as President of the corporation. Therefore, he is personally liable for the payment of those taxes not remitted to the state during that period.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040125.LOF

LETTER OF FINDINGS NUMBER: 04-0125
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for three million, two hundred thousand dollars ($3,200,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040126.LOF

LETTER OF FINDINGS NUMBER: 04-0126
Sales and Use Tax
For Tax Year 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal

Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of sales tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft in 2001 for three million, eight hundred forty five thousand dollars ($3,845,000.00) minus the value of a trade-in aircraft at one million, six hundred fifty two thousand, two hundred and fifty dollars ($1,652,250.00). Taxpayer claimed a sales tax exemption on the purchase of the aircraft. The Department compared a non-related aircraft rental company's rate to the rate taxpayer charged for its aircraft. The rental rate taxpayer charged its two customers ($175/hour) was far below the market rate for a comparable aircraft available for rent from a third party ($2,000/hour). The Department determined that taxpayer was not renting the aircraft and denied the exemption, issuing a proposed assessment on the two million, one hundred ninety two thousand, seven hundred and fifty dollars ($2,192,750.00) taxpayer paid for the aircraft. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customers provided documentation establishing exempt use of the aircraft. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) which states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. As previously explained, the rental rate was a fraction of rental rate charged by third parties for similar aircraft. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Next, taxpayer states that it leases the aircraft to two unrelated parties. Further, these parties are equal owners in the aircraft and therefore carry equal portions of the fixed operating costs and, when they use the aircraft individually, they pay an agreed to rental charge which is fixed in the rental agreement. Taxpayer states that there is substantially disproportionate use between the parties, therefore the establishment of the rental rate will benefit one at the cost of the other. Taxpayer believes this establishes an arms-length transaction.

The Department notes that taxpayer states that the parties are unrelated renters while they are simultaneously equal owners of the aircraft. The Department notes that these two conditions are mutually exclusive and cannot both be correct. An unrelated renter cannot concurrently be an owner of the aircraft. The Department further notes that taxpayer has not provided any documentation that it has ever posted a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7^{th} ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040127.LOF

LETTER OF FINDINGS NUMBER: 04-0127
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of sales tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, four hundred fifty one thousand, eight hundred nineteen dollars ($1,451,819.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> > (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040128.LOF

LETTER OF FINDINGS NUMBER: 04-0128
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred eighty two thousand, five hundred dollars ($182,500.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid

lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040129.LOF

LETTER OF FINDINGS NUMBER: 04-0129
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, six hundred fifteen thousand, five hundred forty four dollars ($1,615,544.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040130.LOF

LETTER OF FINDINGS NUMBER: 04-0130
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2^{nd} Cir. 1949); Black's Law Dictionary (7^{th} ed. 1999)

Taxpayer protests the imposition of sales tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred thirty nine thousand, nine hundred dollars ($139,900.00) minus the trade in value of another aircraft of one hundred ten thousand dollars ($110,000.00) for a final purchase price of twenty nine thousand, nine hundred dollars ($29,900.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

> (4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040131.LOF

LETTER OF FINDINGS NUMBER: 04-0131
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for eight hundred and five thousand dollars ($805,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

> (4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7^{th} ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040132.LOF

LETTER OF FINDINGS NUMBER: 04-0132
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, nine hundred seventy five thousand dollars ($1,975,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department has not received any documentation establishing that taxpayer ever had any income from the rental of the aircraft. The Department was told that the aircraft had been in maintenance for over three (3) years including the previous owner. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental rate at issue was set far below the fair market rate, and there is no indication that anyone ever actually rented the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040140.LOF

LETTER OF FINDINGS NUMBER: 04-0140
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to flight schools. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred fifty nine thousand dollars ($259,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that taxpayer did not provide a copy of any lease agreement, or even that it actually leased to any flight school, while flight logs establish that the two owners of the aircraft were virtually the only users of the aircraft. Even then, the owners paid a substantially reduced rental rate. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Taxpayer also refers to a revenue ruling it obtained from the Department. In the ruling, Issue 1 concerned the rental/leasing exemption. The Department's ruling was that since taxpayer claimed to be purchasing the aircraft for lease/rental purposes, it was able to purchase the aircraft exempt from sales and use taxes. The ruling also explains that, "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 taxpayer any protection." As previously explained, taxpayer has not provided any documentation that it was involved in a valid leasing/rental business. This is as fundamentally different in a material respect from the facts and circumstances given in the ruling as it could be. Therefore, the ruling affords taxpayer no protection.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as

rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040141.LOF

LETTER OF FINDINGS NUMBER: 04-0141
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2^{nd} Cir. 1949); Black's Law Dictionary (7^{th} ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to flight schools. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred fifty nine thousand dollars ($259,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that taxpayer did not provide a copy of any lease agreement, or even that it actually leased to any flight school, while flight logs establish that the two owners of the aircraft were virtually the only users of the aircraft. Even then, the owners paid a substantially reduced rental rate. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Taxpayer also refers to a revenue ruling it obtained from the Department. In the ruling, Issue 1 concerned the rental/leasing exemption. The Department's ruling was that since taxpayer claimed to be purchasing the aircraft for lease/rental purposes, it was able to purchase the aircraft exempt from sales and use taxes. The ruling also explains that, "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 taxpayer any protection." As previously explained, taxpayer has not provided any documentation that it was involved in a valid leasing/rental business. This is as fundamentally different in a material respect from the facts and circumstances given in the ruling as it could be. Therefore, the ruling affords taxpayer no protection.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7^{th} ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040156.LOF

LETTER OF FINDINGS NUMBER: 04-0156
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred twenty five thousand dollars ($125,000.00) and claimed a sales tax exemption.

The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-

15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> > (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040157.LOF

LETTER OF FINDINGS NUMBER: 04-0157
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for seven hundred and eighty five thousand dollars ($785,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040158.LOF

LETTER OF FINDINGS NUMBER: 04-0158
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for eight hundred and ten thousand dollars ($810,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. The rental rate was far below the fair market rate. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040166.LOF

LETTER OF FINDINGS NUMBER: 04-0166
Sales Tax
Responsible Officer
For the Tax Period 1998-1999

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.

ISSUE

1. Sales Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-8.1-5-1(b).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate sales taxes.

STATEMENT OF FACTS

The taxpayer was the trustee of a trust which was an investor in a corporation that did not remit the proper amount of sales taxes during the tax period 1998-1999. The Indiana Department of Revenue assessed the unpaid sales taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

An individual who:

(1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and

(2) has a duty to remit state gross retail or use taxes to the department;

holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state.

The taxpayer produced substantial documentation that he had no duty to collect and remit sales taxes to the state. Therefore, he is not personally responsible for the payment of the corporate sales taxes.

FINDING

The taxpayer’s protest is sustained.

DEPARTMENT OF STATE REVENUE

0120040192.LOF

LETTER OF FINDINGS: 04-0192
Indiana Adjusted Gross Income
For 1999 and 2000

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Constitutionality of Indiana Adjusted Gross Income Tax.

Authority: Ind. Const. art. X, § 8; IC 6-3-1-3.5(a); IC 6-3-1-8; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; United States v. Collins, 920 F.2d 619 (10th Cir. 1990); Betz v. United States, 40 Fed. Cl. 286 (Fed. Cl. 1998); Snyder v. Indiana Dep't of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); 26 U.S.C.S. § 61(a); 26 U.S.C.S. § 62.

Taxpayer argues that he is not subject to the legislation imposing Indiana's adjusted gross income tax because he is a "NATURAL-BORN, FREE adult Citizen* of the Indiana Republic."

II. Proposed Assessment – Adjusted Gross Income Tax.

Authority: IC 6-8.1-1-1; IC 6-8.1-3-1(a); IC 6-8.1-5-1(a).

Taxpayer maintains that he is not required to pay state income taxes because he did not file 1999 or 2000 state tax returns.

STATEMENT OF FACTS

The Department of Revenue (Department) determined that taxpayer owed additional income tax for 1999 and 2000. The Department then sent taxpayer notices of "Proposed Assessment." Taxpayer responded by stating that he did not file returns for either 1999 or 2000 and that he wished to avail himself of "whatever administrative or judicial remedies are available to dispute the alleged liabilities." In addition, taxpayer submitted an "Affidavit" setting out multiple challenges to the applicability of the state's individual income tax.

Taxpayer's response was treated as a formal protest. Taxpayer declined the opportunity to take part in an administrative hearing or to provide supplementary documentation. This Letter of Findings was prepared based upon the initial protest letter and the "Affidavit."

DISCUSSION

I. Constitutionality of Indiana Adjusted Gross Income Tax.

According to taxpayer, "Recent diligent studies have convinced [him] that he is not 'subject to' the territorially-limited 'exclusive Legislation' and its foreign jurisdiction mandated for Washington, D.C....." Taxpayer states that the federal income tax – and by extension Indiana income tax – is the result of a "shrewd and criminal Constructive Fraud... perpetrated upon America by government under counterfeit 'color of law', through apparent entrapments of 'certain ACTIVITIES (monopoly occupations) and PRIVILEGES' (other benefits) allowed by Statutory Acts or otherwise." Having detected an elaborate government plot against its own citizenry, taxpayer decided that it would be best to "REVOKE" all his previous signatures "and render them null and void except for those that I choose to have measured as being under 'TDC' (threat, duress and/or coercion) and/or 'without prejudice' (per UCC 1-207), past and now."

Taxpayer has provided a densely-written, vertigo-inducing challenge to Indiana's authority to impose an individual income tax. To support that challenge, taxpayer has cited to the "U.S. Criminal Codes," Uniform Commercial Code, United States Supreme Court case law, and various provisions of the United States Constitution.

Under the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. X, § 8. The Indiana Tax Court has stated that, "The constitutional legitimacy of the general assembly's decision to tax income is beyond dispute. The right to tax is a crucial attribute of sovereignty." Snyder v. Indiana Dep't of State Revenue, 723 N.E.2d 487, 488 (Ind. Tax Ct. 2000). Under that taxing authority, the General Assembly has enacted the Adjusted Gross Income Tax of 1963 (Act). IC 6-3-1-1 et seq.

The Act defines "adjusted gross income" in the case of individuals, as the term is defined in 26 U.S.C.S. § 62 with certain modifications specific to Indiana. IC 6-3-1-3.5(a). Thus "adjusted gross income" is, "in the case of an individual, gross income minus... [certain] deductions." 26 U.S.C.S. § 62. Similarly, the Act incorporates the definition of "gross income" as found in I.R.C. § 61(a). IC 6-3-1-8. Therefore, "gross income" consists of "all income from whatever source derived...." 26 U.S.C.S. § 61(a).

The Indiana General Assembly has chosen to tax the income earned by individuals and – in defining the extent of the state income tax – has incorporated provisions of the Internal Revenue Code. Taxpayer's conclusion – that he is not subject to state income tax because the federal provisions are applicable only to residents of certain federal enclaves – is not well founded and has been consistently rejected by the courts. "For seventy-five years, the Supreme Court has recognized that the sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation, not just in federal enclaves... [and] efforts to argue otherwise have been sanctioned as frivolous." United States v. Collins, 920 F.2d 619, 629 (10th Cir. 1990) (Internal citation omitted). "Pursuant to the authority vested in Congress under the Sixteenth Amendment to impose a direct income tax on citizens and residents of the United States comprised of the 50 states and the District of Columbia, Congress enacted Title 26 of the United States Code, the Internal Revenue Code." Betz v. United States, 40 Fed. Cl. 286, 295 (Fed. Cl. 1998). "The I.R.C. applies to 'United States persons,' defined as 'citizen[s] or resident[s] of the United States.' 26 U.S.C. § 7701(a)(30)(A) (1994). In addition, the I.R.C.'s definition of 'United States' includes 'the States and the District of Columbia.' 26 U.S.C. § 7701(a)(9) (1994)." Id.

Taxpayer is of the opinion that, with the just the right combination of semantic technicalities and obscure legal references he can render himself immune from Federal and state tax liability. There is not one single Federal or state court case which supports such a fanciful notion. Wishful thinking aside, given that taxpayer received gross income (I.R.C. § 61) in 1999 and 2000, is an "individual" under IC 6-3-1-9, was a resident of Indiana for the years 1999 and 2000 (IC 6-3-1-12), and is a "taxpayer" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayer's income as they do to every other resident of this state.

FINDING

Taxpayer's protest is denied.

II. Proposed Assessment – Adjusted Gross Income Tax.

Taxpayer argues that he is not subject to the state income tax because he did not file Indiana tax returns and that he has officially revoked his permission for anyone to prepare a tax return on his behalf.

Under IC 6-8.1-3-1(a), "The department [of revenue] has the primary responsibility for the administration, collection, and enforcement of the listed taxes." The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "the adjusted gross income tax" as one of the Indiana's "listed taxes." As one aspect of that responsibility, the Department is required to issue a "proposed assessment" if there is reason to believe that an individual has underreported his income. "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of unpaid tax on the basis of the best information available." IC 6-8.1-5-1(a). In taxpayer's own case, the Department relied on information contained within taxpayer's W-2 and 1099 forms indicating that taxpayer had obtained income during these years. Taxpayer has done nothing which refutes or brings into question the accuracy of this data.

Taxpayer also complains that the notice of proposed assessment is not signed. It is somewhat difficult to determine the specific nature of taxpayer's grievance. Although a personalized notice of proposed assessment might have certain advantages, there is nothing in the statutes or regulations which require that a notice of proposed assessment contain a signature. It is sufficient that the document place the taxpayer on notice of a potential tax deficiency and that the taxpayer be provided with the means by which to challenge that assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120040193.LOF

LETTER OF FINDINGS: 04-0193
Indiana Adjusted Gross Income
For 1999 and 2000

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Constitutionality of Indiana Adjusted Gross Income Tax.

Authority: Ind. Const. art. X, § 8; IC 6-3-1-3.5(a); IC 6-3-1-8; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; United States v. Collins, 920 F.2d 619 (10th Cir. 1990); Betz v. United States, 40 Fed. Cl. 286 (Fed. Cl. 1998); Snyder v. Indiana Dep't of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); 26 U.S.C.S. § 61(a); 26 U.S.C.S. § 62.

Taxpayer argues that she is not subject to the legislation imposing Indiana's adjusted gross income tax because she is a "NATURAL-BORN, FREE adult Citizen* of the Indiana Republic."

II. Proposed Assessment – Adjusted Gross Income Tax.

Authority: IC 6-8.1-1-1; IC 6-8.1-3-1(a); IC 6-8.1-5-1(a).

Taxpayer maintains that she is not required to pay state income taxes because she did not file 1999 or 2000 state tax returns.

STATEMENT OF FACTS

The Department of Revenue (Department) determined that taxpayer owed additional income tax for 1999 and 2000. The Department then sent taxpayer notices of "Proposed Assessment." Taxpayer responded by stating that she did not file returns for either 1999 or 2000 and that she wished to avail herself of "whatever administrative or judicial remedies are available to dispute the alleged liabilities." In addition, taxpayer submitted an "Affidavit" setting out multiple challenges to the applicability of the state's individual income tax.

Taxpayer's response was treated as a formal protest. Taxpayer declined the opportunity to take part in an administrative hearing or to provide supplementary documentation. This Letter of Findings was prepared based upon the initial protest letter and the "Affidavit."

DISCUSSION

I. Constitutionality of Indiana Adjusted Gross Income Tax.

According to taxpayer, "Recent diligent studies have convinced [her] that [s]he is not 'subject to' the territorially-limited 'exclusive Legislation' and its foreign jurisdiction mandated for Washington, D.C....." Taxpayer states that the federal income tax – and by extension Indiana income tax – is the result of a "shrewd and criminal Constructive Fraud... perpetrated upon America by government under counterfeit 'color of law', through apparent entrapments of 'certain ACTIVITIES (monopoly occupations) and PRIVILEGES' (other benefits) allowed by Statutory Acts or otherwise." Having detected an elaborate government plot against its own citizenry, taxpayer decided that it would be best to "REVOKE" all her previous signatures "and render them null and void except for those that I choose to have measured as being under 'TDC' (threat, duress and/or coercion) and/or 'without prejudice' (per UCC 1-207), past and now."

Taxpayer has provided a densely-written, vertigo-inducing challenge to Indiana's authority to impose an individual income tax. To support that challenge, taxpayer has cited to the "U.S. Criminal Codes," Uniform Commercial Code, United States Supreme Court case law, and various provisions of the United States Constitution.

Under the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. X, § 8. The Indiana Tax Court has stated that, "The constitutional legitimacy of the general assembly's decision to tax income is beyond dispute. The right to tax is a crucial attribute of sovereignty." Snyder v. Indiana Dep't of State Revenue, 723 N.E.2d 487, 488 (Ind. Tax Ct. 2000). Under that taxing authority, the General Assembly has enacted the Adjusted Gross Income Tax of 1963 (Act). IC 6-3-1-1 et seq.

The Act defines "adjusted gross income" in the case of individuals, as the term is defined in 26 U.S.C.S. § 62 with certain modifications specific to Indiana. IC 6-3-1-3.5(a). Thus "adjusted gross income" is, "in the case of an individual, gross income minus... [certain] deductions." 26 U.S.C.S. § 62. Similarly, the Act incorporates the definition of "gross income" as found in I.R.C. § 61(a). IC 6-3-1-8. Therefore, "gross income" consists of "all income from whatever source derived...." 26 U.S.C.S. § 61(a).

The Indiana General Assembly has chosen to tax the income earned by individuals and – in defining the extent of the state income tax – has incorporated provisions of the Internal Revenue Code. Taxpayer's conclusion – that she is not subject to state income tax because the federal provisions are applicable only to residents of certain federal enclaves – is not well founded and has been consistently rejected by the courts. "For seventy-five years, the Supreme Court has recognized that the sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation, not just in federal enclaves... [and] efforts to argue otherwise have been sanctioned as frivolous." United States v. Collins, 920 F.2d 619, 629 (10th Cir. 1990) (Internal citation omitted). "Pursuant to the authority vested in Congress under the Sixteenth Amendment to impose a direct income tax on citizens and residents of the United States comprised of the 50 states and the District of Columbia, Congress enacted Title 26 of the United States Code, the Internal Revenue Code." Betz v. United States, 40 Fed. Cl. 286, 295 (Fed. Cl. 1998). "The I.R.C. applies to 'United States persons,' defined as 'citizen[s] or resident[s] of the United States.' 26 U.S.C. § 7701(a)(30)(A) (1994). In addition, the I.R.C.'s definition of 'United States' includes 'the States and the District of Columbia.' 26 U.S.C. § 7701(a)(9) (1994)." Id.

Taxpayer is of the opinion that, with the just the right combination of semantic technicalities and obscure legal references she can render herself immune from Federal and state tax liability. There is not one single Federal or state court case which supports such a fanciful notion. Wishful thinking aside, given that taxpayer received gross income (I.R.C. § 61) in 1999 and 2000, is an "individual" under IC 6-3-1-9, was a resident of Indiana for the years 1999 and 2000 (IC 6-3-1-12), and is a "taxpayer" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayer's income as they do to every other resident of this state.

FINDING

Taxpayer's protest is denied.

II. Proposed Assessment – Adjusted Gross Income Tax.

Taxpayer argues that she is not subject to the state income tax because she did not file Indiana tax returns and that she has officially revoked her permission for anyone to prepare a tax return on her behalf.

Under IC 6-8.1-3-1(a), "The department [of revenue] has the primary responsibility for the administration, collection, and enforcement of the listed taxes." The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "the adjusted gross income tax" as one of the Indiana's "listed taxes." As one aspect of that responsibility, the Department is required to issue a "proposed assessment" if there is reason to believe that an individual has underreported his income. "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of unpaid tax on the basis of the best information available." IC 6-8.1-5-1(a). In taxpayer's own case, the Department relied on information contained within taxpayer's W-2 and 1099 forms indicating that taxpayer had obtained income during these years. Taxpayer has done nothing which refutes or brings into question the accuracy of this data.

Taxpayer also complains that the notice of proposed assessment is not signed. It is somewhat difficult to determine the specific nature of taxpayer's grievance. Although a personalized notice of proposed assessment might have certain advantages, there is nothing in the statutes or regulations which require that a notice of proposed assessment contain a signature. It is sufficient that the document place the taxpayer on notice of a potential tax deficiency and that the taxpayer be provided with the means by which to challenge that assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040202.LOF

LETTER OF FINDINGS NUMBER: 04-0202
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred sixty six thousand dollars ($166,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040203.LOF

LETTER OF FINDINGS NUMBER: 04-0203
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for four hundred forty five thousand dollars ($445,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040204.LOF

LETTER OF FINDINGS NUMBER: 04-0204
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for three hundred sixty two thousand, two hundred and fifty dollars ($362,250.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

> (4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that a single individual signed as both lessee and lessor on the leasing agreement. Combined with the rental rate far below normal market rates, this shows that taxpayer was not occupationally engaged in reselling, renting or leasing the aircraft in the regular course of its business. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040205.LOF

LETTER OF FINDINGS NUMBER: 04-0205
Sales and Use Tax
For Tax Years 2001

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, four hundred seventy four thousand and three dollars ($1,474,003.00) minus the trade in value of another aircraft at three hundred forty thousand, one hundred dollars ($340,100.00) for a final selling price of one million, one hundred thirty three thousand, nine hundred and three dollars ($1,133,903.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040206.LOF

LETTER OF FINDINGS NUMBER: 04-0206
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for three hundred forty seven thousand, five hundred dollars ($347,500.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> > (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040207.LOF

LETTER OF FINDINGS NUMBER: 04-0207
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred fifty two thousand, five hundred seventy one dollars ($252,571.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid

lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040208.LOF

LETTER OF FINDINGS NUMBER: 04-0208
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred eight thousand, five hundred thirty dollars ($108,530.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040209.LOF

LETTER OF FINDINGS NUMBER: 04-0209
Sales and Use Tax
For Tax Years 2001 and 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of sales tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased three aircraft, but did not pay sales tax on the purchases. Taxpayer claimed that the purchases were exempt from sales tax because the aircraft were to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased two aircraft in 2001 for one million, seven hundred thirty thousand dollars ($1,730,000.00) and four million, two hundred thousand dollars ($4,200,000.00) respectively. Taxpayer purchased one aircraft in 2002 for eleven million, eight hundred two thousand, three hundred and fifty-five dollars ($11,802,355.00). Taxpayer claimed a sales tax exemption on the purchase of all three aircraft. The Department compared a non-related aircraft rental company's rate to the rate taxpayer charged for its aircraft. The rental rates taxpayer charged its customer were far below the market rates for comparable aircraft. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

> (4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. As previously explained, the rental rates were a fraction of rental rates charged by third parties for similar aircraft. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Taxpayer states that it was formed for the purpose of leasing the aircraft to charter companies and, since the charter companies would have been exempt from paying sales tax on the aircraft had they purchased it directly, that there is no tax savings involved in the transaction. The Department notes that taxpayer has not provided documentation establishing that its customer was in fact tax-exempt. Also, the Department has not received documentation establishing that the aircraft was leased or rented to any other parties. Taxpayer has not provided any other documentation concerning the use of the aircraft.

The only activity upon which the Department has documentation is the rental from taxpayer to its customer at a rental rate far below the rate charged by third parties for similar aircraft. The leasing agreements supplied to the Department were unsigned by both lessor and lessee. Again, 45 IAC 2.2-5-15 requires a taxpayer to be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The documentation and lack thereof show that taxpayer does not qualify for this exemption. Taxpayer's claim that there are no tax savings under its arrangement is incorrect.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040248.LOF

LETTER OF FINDINGS NUMBER: 04-0248
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for three hundred forty thousand dollars ($340,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220040249.LOF

LETTER OF FINDINGS NUMBER: 04-0249
Corporate Income Tax
For the Year 2002

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.

ISSUE

I. Corporate Income Tax—Assessment

Authority: IC 6-8.1-5-1(b); IC 6-3-4-14; IC 6-3-2-2; 45 IAC 3.1-1-39; Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983); Wabash, Inc. v. Department of State Revenue, 729 N.E.2d 620 (Ind. Tax 2000); Sherwin-Williams Co. v. Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax 1996)

Taxpayer protests adjustment made by the Department to Taxpayer's corporate income tax return. Taxpayer protests the computation and assessment of corporate income tax by the Department based on the standard method instead of Taxpayer's computations based on the stacked method.

II. Corporate Income Tax—Assessment of Penalties

Authority: IC 6-8.1-5-1(a); IC 6-8.1-10

Taxpayer protests the assessment of penalties by the Department.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation engaged in manufacturing activities inside and outside Indiana. Taxpayer filed a consolidated corporate return including two wholly-owned subsidiaries, Sub One and Sub Two. Taxpayer, Sub One, and Sub Two calculated their consolidated Indiana adjusted gross income for the 2002 tax year using the post-apportionment method, commonly called the stacked method. The Department reviewed the return and calculated the income tax due using the pre-apportionment method, commonly called the standard method. The Department issued an adjustment and assessment for the tax due. Penalties and interest also were assessed. Taxpayer filed a protest and a hearing was held.

I. Corporate Income Tax—Assessment

DISCUSSION

Under Indiana code, tax assessments are presumed to be valid and accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-3-4-14 affirmatively permits an affiliated group of corporations the privilege of filing a consolidated return, so long as each member company has adjusted gross income derived from Indiana sources. The filing of a consolidated return is conditioned upon all the members of the affiliated group consenting to all the provisions of federal and Indiana income tax code—including regulations promulgated by the Department. *Id*. The filing of the return is considered to be that consent. *Id*. IC 6-3-2-2 provides a three factor apportionment formula for determining income derived from Indiana sources.

IC 6-3-2-2(b) computes the apportionment of Indiana income by summing a Taxpayer's property, payroll, and sales factors—then dividing this by four, with the sales factor being double-weighted. The tax due is determined by multiplying that income by the tax rate. This is termed the standard method. However, if the standard method fails to fairly reflect Indiana sourced income, the Department may use another method that effectuates a more equitable allocation and apportionment of a taxpayer's income. *See* 45 IAC 3.1-1-39. A taxpayer may use another method—if it obtains a ruling from the Department. *Id*.

In previous years, Taxpayer has used the stacked method. Under the stacked method, the individual tax for each member company is computed—then summed to arrive at the consolidated tax amount. This varies from the standard method which combines all the member companies' factors and then computes the tax due. Taxpayer advocates that the stacked method better reflects its Indiana sourced income because that computational method better reflects the operational logistics of its member companies. Taxpayer also advocates that since it has used the stacked method in the past—with the approval of the Department—the assessment by the Department using the standard method on the 2002 return is inequitable, based on reliance.

The United States Supreme Court, the Indiana Tax court, and the Department all recognize that the standard method is the method most used by related corporations to compute their state income taxes. In Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 170 (1983), the United States Supreme Court not only affirmed the standard formula but also stated that it has become a benchmark against which other apportionment formulas are judged. The Indiana Tax Court recognizes Indiana's reliance on the standard formula. *See* Wabash, Inc. v. Department of State Revenue, 729 N.E.2d 620, 625 (Ind. Tax 2000) and Sherwin-Williams Co. v. Dept. of State Revenue, 673 N.E.2d 849, 851 (Ind. Tax 1996). The basic premise and intent of a consolidated income tax return is that the group is treated as a single corporation. Wabash, 729 N.E.2d at 626. In a consolidated return, the separate entities of the various member corporations are disregarded; the consolidated income of the entire group is reported on a single return and a single tax is paid on the total income. *Id*. Based on this, great deference and weight is given to using the standard method. Deviations from the standard method must be justified.

45 IAC 3.1-1-39 requires a Taxpayer to acquire a ruling permitting the use of different formula which more fairly reflects its income from Indiana sources. Taxpayer asserts that the stacked method used by it was expressly reviewed and accepted by the Department when Taxpayer was audited for the tax years 1993 through 1998. Taxpayer adds that since that audit, no substantial changes in operations have occurred. Based on these facts, Taxpayer reasonably could have concluded that the Department had authorized Taxpayer to use the stacked method. But it now is stated plainly that Taxpayer was and is on notice that it will be required to compute its tax liabilities using the standard method—unless Taxpayer secures a ruling from the Department to use an alternative method.

FINDING

Taxpayer's protest is sustained. Taxpayer's return for 2002 is accepted using the computations under the stacked method. The assessment was issued on May 3, 2004. This is the date that Taxpayer was placed on notice that the standard method is the required computational method for a consolidated return—unless a ruling is secured by Taxpayer from the Department to use an alternative method.

II. Corporate Income Tax—Assessment of Penalties

DISCUSSION

Under IC 6-8.1-5-1(a), the amount of the assessment is considered a tax payment not made by the due date and is subject to IC 6-8.1-10 concerning the imposition of penalties and interest. Because Taxpayer is sustained on the protest to the assessment, the penalties issue is moot.

FINDING

Taxpayer's protest is sustained—based on being a moot issue.

DEPARTMENT OF STATE REVENUE

0420040250.LOF

LETTER OF FINDINGS NUMBER: 04-0250
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for three hundred forty thousand dollars ($340,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040257.LOF

LETTER OF FINDINGS NUMBER: 04-0257
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, three hundred seventy seven thousand, seven hundred twenty four dollars ($1,377,724.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> > (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040258.LOF

LETTER OF FINDINGS NUMBER: 04-0258
Sales and Use Tax
For Tax Years 2004

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred sixty thousand dollars ($260,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220040251.LOF

LETTER OF FINDINGS: 04-0251
Indiana Corporate Income Tax
For the Years 1994 to 2000

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 publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Applicability of the Indiana Adjusted Gross Income Tax and Gross Income Tax.

Authority: U.S. Const. art. I, § 8, cl. 3; U.S. Const. amend. XIV, § 8; IC 6-2.1-2-2; IC 6-3-1-1 et seq.; IC 6-3-2-2(a); 45 IAC 1-1-51;

45 IAC 3.1-1-55; Quill Corp. v. North Dakota, 504 U.S. 298 (1992); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Int'l Harvester Co. v. Wisconsin Department of Taxation, 322 U.S. 435 (1944); Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936); Gregory v. Helvering 293 U.S. 465 (1935); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264 (Ind. 1994); Hoosier Energy v. Dept. of State Revenue, 572 N.E.2d 481 (Ind. 1991); Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13 (S.C. 1993); Lanco, Inc. v. Dir., Div. of Taxation, No. 005329-97, 2003 N.J. Tax LEXIS 18; Del. Code Ann. tit. 30 § 1902(b)(8).

Taxpayer argues that the royalties it earned from licensing intellectual property were not subject to Indiana corporate income tax.

II. Apportionment Formula.

Authority: IC 6-3-2-1(b); IC 6-3-2-2(b); IC 6-3-2-2(c); IC 6-3-2-2(l); 45 IAC 3.1-1-39.

Taxpayer states that if it is subject to the Indiana's adjusted gross income tax, the audit's application of a single factor apportionment formula was erroneous because it distorted the amount of taxpayer's Indiana adjusted gross income.

III. Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1(a); IC 6-8.1-10-2(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer requests that the Department of Revenue (Department) exercise its discretion to abate the ten-percent negligence penalty made against taxpayer's additional corporate income tax assessment.

STATEMENT OF FACTS

Taxpayer is a Delaware company in the business of licensing intellectual property consisting of trade marks and service marks. Taxpayer is owned by a retail chain store which conducts business nationwide including retail locations within Indiana. The intellectual property originally belonged to the retail chain store but was transferred to taxpayer by means of an I.R.C. § 351 tax free exchange. In return for receiving ownership of the intellectual property, the retail chain store received 100 percent of the taxpayer's stock.

Thereafter, taxpayer and the retail chain store entered into a "Licensing Agreement" which enabled the retail chain store to continue use of the intellectual property it had previously owned. In return, the retail chain store paid taxpayer royalties based upon a percentage of net sales of products sold bearing the trademarks. The retail chain store paid approximately 3 percent of its net sales to taxpayer. The royalties were paid to taxpayer by means of an electronic fund wire transfer. Once taxpayer received the royalties, it loaned the money back to the retail chain store. Taxpayer loaned the money by means of an electronic fund transfer.

According to taxpayer, it also received royalties from "unrelated third parties such as joint ventures and franchisees."

Taxpayer did not file Indiana corporate income tax returns during the periods of time at issue. The Department of Revenue conducted an audit review of taxpayer's business records and found that because taxpayer was licensing the intellectual property for use within Indiana and because it received money for doing so, taxpayer should have been paying corporate income tax on that money. Accordingly, the Department sent taxpayer notices of "Proposed Assessment" covering 1994 to 2000. Taxpayer disagreed with the proposed assessments and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Applicability of the Indiana Adjusted Gross Income Tax and Gross Income Tax.

The audit found that Indiana is the business situs of taxpayer's intellectual property and that income derived from the use of the intellectual property within this state constitutes Indiana source income properly taxable to the state of the Indiana. Taxpayer disagrees pointing out that it has no employees within Indiana and does not own tangible or intangible property within the state. Taxpayer argues that the audit's position is invalid because the proposed assessments allegedly violate the Due Process and Commerce Clauses of the United States Constitution.

A. Adjusted Gross Income Tax.

Indiana imposes an adjusted gross income tax on income derived from sources within the state. The adjusted gross income tax, IC 6-3-1-1 et seq., is an apportioned tax specifically designed to reach income derived from interstate transactions. Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264, 266 n. 4 (Ind. 1994). The legislature has defined "adjusted gross income" as follows:

> (1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter. IC 6-3-2-2(a).

In order for Indiana to tax the income derived from an intangible, the intangible – such as taxpayer's intellectual property – must have acquired a "business situs" within the state. 45 IAC 3.1-1-55 states that "[t]he situs of intangible personal property is the commercial domicile of the taxpayer... unless the property has acquired a 'business situs' elsewhere. 'Business situs' is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property."

The Department concludes that taxpayer's intellectual property has acquired a "business situs" within Indiana. Taxpayer licenses the intellectual property for the exclusive use by the retail chain store which sells goods bearing taxpayer's trade and service marks. Based upon the parties' agreement and the independent valuation of the value of these marks, it is evident that the parties attach significant value to the trade and service marks. As the independent valuation states, "The use of the [] trade names would provide entry into the retail [] market, which could not be achieved without the acquisition of a well-known name." Elsewhere, the valuation noted that, "The [] trade name is the leader in the retail [] market and a stronger name than the franchise names employed for comparison."

The value taxpayer derives from the exploitation of the intellectual property is attributable entirely to activities occurring within the state of Indiana. The value of the intellectual property to the taxpayer consists of the ability to "place" that intellectual property within the state and to derive the consequent benefits attributable entirely to the intellectual property's Indiana business situs. As the regulation itself states, "'Business situs' is the place at which [the] intangible personal property is employed as capital...." 45 IAC 3.1-1-55. The place at which "value attaches to the [intellectual] property" is within the state of Indiana. Id. The significant value attached to these properties derives entirely from the ability to assign the properties for use within the state. Taxpayer reaps benefits in the form of royalties directly attributable to retail sales made to Indiana customers.

However, taxpayer interposes several constitutional arguments which would have the effect of limiting Indiana's ability to tax the income attributable to the intellectual property. Taxpayer states that "[t]he imposition of taxation on [taxpayer] as a foreign corporation violates the Commerce Clause and the Due Process Clause of the U.S. Constitution." Taxpayer is correct in its assertion that both the Due Process Clause, U.S. Const. amend. XIV, § 8, and the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, require that there exist a minimum connection between a state and the object of the tax and that those constitutional requirements must be met before Indiana can exercise taxing authority over taxpayer's income.

In Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992), the Supreme Court stated that "[t]he Due Process Clause 'requires some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax.'" However, the Court concluded that the due process requirement is satisfied "if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state.... even if the [the taxpayer] has no physical presence in the state." Id. at 307. Although taxpayer's physical existence – measured by its business location, employees, and corporate existence – may be confined within Delaware's boundaries, taxpayer has directed its activities at the residents of Indiana and at the benefits conferred by Indiana in making it possible for taxpayer to conduct business within the state. Taxpayer has not been unwillingly brought into contact with Indiana by the unforeseen and unilateral actions of an independent third-party. To the contrary, there is every indication that taxpayer directed its activities toward licensing the intellectual property to the retail chain store and received substantial income from the use of the intellectual property within the state. The fact that Indiana confers protection, benefits, and opportunities upon taxpayer is apparent from taxpayer's simple ability to derive income from conducting business within the state. Therefore, under the standards set out in the Quill decision, the Due Process Clause does not prevent Indiana from taxing the income derived by taxpayer in availing itself of the Indiana business situs.

Taxpayer argues that Indiana may not tax its income by virtue of the protections afforded under the Commerce Clause. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977), the Supreme Court outlined a four-part test for determining whether a state's exercise of its taxing authority is offensive to the Commerce Clause. The Court stated the exercise of the state's taxing authority would survive a constitutional challenge "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." Id. Taxpayer argues that the proposed tax violates the Commerce Clause because taxpayer does not have a "substantial nexus" with Indiana and because the tax is not "fairly apportioned."

Taxpayer claims that it does not have a "substantial nexus" with Indiana because it is not commercially domiciled in Indiana, does not have a business situs in Indiana, conducts no business in Indiana, derives no services from Indiana, and has no employees or property within the state. However, as the court in Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13, 23 (S.C. 1993), *cert. denied,* 510 U.S. 992 (1993), noted, "It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property is sufficient alone to establish nexus." That determination echoed the standard set out by the Supreme Court in Int'l Harvester Co. v. Wisconsin Department of Taxation, 322 U.S. 435, 441-442 (1944) when the Court stated that, "A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers." (*See also* Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936) "The rule that the taxable situs of intangibles is at the technical domicile of the owner is but a mere fiction, and will not be followed when the fact is clear that the intangible property has a situs elsewhere.") The contractual relationship between taxpayer and Indiana parent company creates the requisite "substantial nexus" with Indiana necessary for Indiana to subject taxpayer to its adjusted gross income tax. By virtue of that licensing agreement, the retail chain store uses the intellectual property to enhance the value of the products sold within the state and to generate the sales which form the basis upon which the taxpayer receives a stream of royalty income.

In addition, the taxpayer argues that the proposed tax violates the Commerce Clause because the tax is not "fairly apportioned." Taxpayer apparently argues that the income at issue should "apportioned" back to the state of Delaware. As the court in Hoosier Energy v. Dept. of State Revenue, 572 N.E.2d 481, 485 (Ind. 1991) stated, "As a general proposition, a state tax on interstate commerce must be fairly apportioned to prevent excessive taxes on such sale as each state takes its bite out of the interstate transaction as it passes through each taxing state." Therefore, in order for a tax to meet the Complete Auto "fairly apportioned" requirement, the state must demonstrate that the taxpayer's income is not consumed by multiple states exercising successive taxing authority over the same income in a manner which offends the Commerce Clause. However, taxpayer has presented no evidence indicating that the income is in anyway potentially subject to multiple taxation. The only other state which could conceivably exercise taxing authority over the income is Delaware, taxpayer's putative business location. There is simply no indication that Delaware has or will subject the income to its taxing authority. To the contrary, Del. Code Ann. tit. 30 § 1902(b)(8) would seem to specifically exempt income derived from intellectual property from the state's taxing authority. The Delaware statute states, in relevant part that:

> The following corporations shall be exempt from taxation under this chapter: (8) Corporations whose activities within this State are confined to the maintenance and management of their intangible investments... and the collection and distribution of the income from such investments.... For purposes of this paragraph, "intangible investments" shall include, without limitation, investments in... patents, patent applications, trademarks, trade names and similar types of intangible assets....

In the absence of any indication that taxpayer's income would be subject to successive taxation by multiple states, taxpayer's "fairly apportioned" argument must fail. To the contrary, the evidence supports the conclusion that the imposition of the state's adjusted gross income tax meets the apportionment requirements set forth in Complete Auto.

Taxpayer cites to Lanco, Inc. v. Dir., Div. of Taxation, No. 005329-97, 2003 N.J. Tax LEXIS 18, for supporting its assertion that a state may not constitutionally subject an out-of-state corporation to that state's income tax where the out-of-state corporation has no physical presence in the state and derives income only pursuant to a license agreement with another corporation that conducts a retail business there. Taxpayer correctly points out that the New Jersey Tax Court "determine[d] that the state may not assert nexus, absent physical presence against a corporation that receives income from the use of trademarks or other intangibles employed in a New Jersey business conducted by an affiliated corporation." Id. at *34. However, the Department – unlike the New Jersey Tax Court – is unwilling to overlook the issues of common ownership and the issues concerning the manner and means by which ownership of the intellectual property was transferred from the retail chain store to taxpayer. *See* Lanco at *2. Taxpayer is paid millions of dollars in royalties by retail chain store for no apparent purpose. There is no indication that taxpayer does anything to earn these royalties. Taxpayer loans the royalties back to retail chain store with no apparent expectation of repayment. The stock exchange agreement, the licensing agreement, the Delaware incorporation, the royalty payments, and the on-going "loans" of the royalties, constitute no more than an elaborate ruse intended to minimize the retail chain store's state tax liability. In such instances, the Department is entitled to overlook the artifice and determine the business and practical realities of the parties' relationship and the tax consequences attendant upon that relationship. Gregory v. Helvering 293 U.S. 465, 469 (1935); *See also* Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert denied,* 338 U.S. 955 (1950).

Accordingly, because taxpayer's intellectual property has acquired an Indiana "business situs," and because Indiana's exercise of taxing authority over the income derived from that property does not offend either the Due Process Clause or the Commerce Clause, taxpayer's income is properly subject to the state's adjusted gross income tax scheme.

B. Gross Income Tax.

In addition to the adjusted gross income tax, Indiana imposes a tax, known as the "gross income tax," on the "taxable gross income" of a taxpayer who is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC 6-2.1-2-2.

Under the regulations governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51. The term "intangibles" includes:

> notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, leases, royalties, certificates of sale, choses in action *and any and all other evidences of similar rights capable of being transferred, acquired or sold.* (*Emphasis added*). Id.

In order for Indiana to impose the gross income tax on income derived from taxpayer's intangibles, the Department must determine that the income is derived from a "business situs" within the state. Id. The regulation states that taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana...." Id. Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." Id.

For purposes of the state's gross income tax, the Department concludes that income derived from the taxpayer's licensing of the intellectual property, is income derived from a "business situs" within Indiana and is properly subject to the state's gross income tax scheme. The intellectual property is exclusively licensed to the retail chain store. The intellectual property is "localized" within the state in the sense that the Indiana chain store employs the property to enhance the value of goods sold within the state to Indiana customers. Taxpayer would derive no income from the intellectual property but for the fact that the intellectual property was licensed for use within Indiana and then actually used within Indiana in conjunction with retail sales occurring within the state.

Accordingly, because the intangible intellectual property has acquired a business situs within the state and because the income at issue is "connected with that business, either actually or constructively," the income is subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Apportionment Formula.

Taxpayer sets out a second challenge to the proposed assessments by challenging the manner in which the audit apportioned taxpayer's income.

Indiana imposes a tax on a corporation's adjusted gross income derived from sources within Indiana. IC 6-3-2-1(b). Where the corporation earns business income from sources within the state and from sources outside the state, the adjusted gross income is determined by an apportionment formula. IC 6-3-2-2(b). The apportionment formula multiplies the corporation's total business income by a fraction the numerator of which is a property factor plus a payroll factor plus a sales factor, and the denominator of which is three. Id. "The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year...." IC 6-3-2-2(c).

Since taxpayer did not prepare Indiana income tax returns or report Indiana income, the audit prepared returns on taxpayer's behalf. According to the audit, this "had to be calculated using information supplied by the taxpayer." The audit report indicated that taxpayer's "rent and payroll [] never exceeded $2000... [that] the rent and payroll [was] not related to the earnings of the royalty income, and therefore have not been included in the apportionment calculation."

Taxpayer objects to the audit's methodology suggesting that the audit's apportionment methodology unduly distorted the amount of taxpayer's adjusted gross income. However, taxpayer has provided no alternative other than to maintain that, "the taxes asserted in the notices are out of all appropriate proportion to, and do not fairly represent the business, if any, conducted by [taxpayer] in Indiana and therefore are unconstitutional." Taxpayer insists that, "An alternative apportionment formula must be applied to reflect a less distortive income apportionment."

IC 6-3-2-2(l) provides as follows:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable;

(1) separate accounting;

(2) the exclusion of any one (1) or more of the factors;

(3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The Department has stated that, "All corporations subject to the allocation and apportionment provisions of IC 6-3-2-2(b) to (n) shall apportion their business income by use of the 3-factor formula... unless the taxpayer obtains a ruling which permits, or the Department requires, the use of a different formula which more fairly reflects its income from Indiana sources." 45 IAC 3.1-1-39.

The audit departed from the standard three-factor apportionment formula when it chose to eliminate consideration of the property and payroll factors. The audit did so because the amounts of the taxpayer's rental and payroll expenses never exceeded $2,000 during the three audited years and because the identifiable rental and payroll expenses were unrelated to the apportioned royalty income. Because the payroll and property expenses were negligible in relation to the amounts of royalty income and because the expenses were unrelated to that royalty income, the audit was correct in excluding the payroll and property factors from the standard apportionment calculation because including the two factors would not have accurately reflected taxpayer's Indiana sourced royalty income.

FINDING

Taxpayer's protest is respectfully denied.

III. Ten-Percent Negligence Penalty.

Taxpayer argues that the Department should exercise its discretion to abate the ten-percent negligence penalty imposed pursuant to IC 6-8.1-10-2.1(a). Taxpayer maintains that the Department has been inconsistent in its stance on taxation of income attributable to intellectual property.

IC 6-8.1-10-2.1(d) provides potential relief from imposition of the penalty. The statute states that if a person – subject to the negligence penalty imposed under IC 6-8.1-10-2.1(a) – can demonstrate that the failure to file a tax return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay a deficiency determined by the Department, was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2(b) defines "negligence" as the failure to use the "reasonable care, caution, or diligence, as would be expected of an ordinary reasonable taxpayer." Negligence results from a "taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations."

In order to waive the negligence penalty, the taxpayer must demonstrate that its failure to pay the full amount of tax was due to "reasonable cause." 45 IAC 15-11-2(c). Taxpayer may establish "reasonable cause" by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...." Id. In determining whether "reasonable cause" exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

Even given taxpayer's argument that issues related to the taxation of income received from intellectual property is an unsettled area of Indiana law, the Department is unable to agree that taxpayer's decision not to file Indiana tax returns was an exercise in "ordinary business care and prudence...." 45 IAC 15-11-2(c). Taxpayer's decision to report none of the Indiana royalties as Indiana income or to obtain direction from the Department concerning the taxability of this income is not suggestive of the "reasonable care, caution, or diligence, as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420040271.LOF

LETTER OF FINDINGS NUMBER: 04-0271
Sales Tax
For the Year 2002

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.

ISSUE

Sales Tax—Assessment; Exemption for Rental and Leasing

Authority: IC 6-8.1-5-1(b); IC 6-2.5-2-1; IC 6-2.5-9-6; IC 6-2.5-5; IC 6-2.5-5-8; IC 6-2.5-4-10(a); IC 6-2.5-8-1; IC 6-2.5-9-2; IC 6-2.5-8-1(b); Panhandle Eastern Pipeline Company v. Dept. of Revenue, 741 N.E.2d 816, 818 (Ind. Tax 2001);

Taxpayer protests the assessment of sales or use tax on the purchase of an aircraft Taxpayer asserts is being used for rental or leasing.

STATEMENT OF FACTS

On April 12, 2002, Taxpayer filed Articles of Incorporation with the Indiana Secretary of State to register a For-Profit Domestic Corporation. The corporate name chosen included the words "Leasing Company, Inc." On April 15, 2002, Taxpayer purchased a 1978 Cessna 421C. Four months later on August 12, 2002, the Compliance Division—Aeronautics of the Indiana Department of Revenue sent a letter to Taxpayer informing Taxpayer that the aircraft was not properly registered with the State of Indiana—which is required to be done within 31 days after purchase. The Department enclosed an application for the benefit of Taxpayer to complete. Taxpayer completed and submitted Form 7695, **Application for Aircraft Registration or Exemption**. Taxpayer elected exemption from sales/use tax: **Rental or Lease to others**. Two months later, on October 2, 2002, Taxpayer submitted an application for a retail merchants number.

Sixteen months later on February 25, 2004, the Compliance Division sent a letter to Taxpayer disallowing the sales/use tax exemption on the basis that Taxpayer had remitted a minimal amount or no sales/use tax. Taxpayer protested the assessment. Compliance sent a reply letter requesting specific information and documentation to substantiate the protest. Compliance reminded Taxpayer that the supporting documentation was required to have been submitted with the protest. Taxpayer later submitted the documentation. On June 9, 2004, the protest was referred to the Legal Division. On September 1, 2004 a hearing was set for November 30, 2004. That hearing was held and this Letter of Findings results.

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). Indiana retail transactions are subject to the imposition of an excise tax—known as the state gross retail tax. IC 6-2.5-2-1. Sales/use tax is due on the purchase of an aircraft. *See* IC 6-2.5-9-6. Exemptions to sales/use tax exist. *See* IC 6-2.5-5. One exemption is property acquired for resale, rental, or leasing in course of business. IC 6-2.5-5-8. However, tax exemption statutes are construed strictly in favor of taxation. Panhandle Eastern Pipeline Company v. Dept. of Revenue, 741 N.E.2d 816, 818 (Ind. Tax 2001). To prevail, Taxpayer must prove that it meets the requirements of IC 6-2.5-5-8.

IC 6-2.5-4-10(a) states that a person is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person. IC 6-2.5-8-1 states that a retail merchant may not make a retail transaction in Indiana, unless he has applied for a registered retail merchant's certificate. A merchant who makes a retail transaction without having applied for and obtaining a registered retail merchant's certificate commits a class B misdemeanor. IC 6-2.5-9-2. Taxpayer's corporate name includes the words **Leasing Company, Inc**. While corporate names may vary—the use of these terms is an indicator of Taxpayer's business intentions. However, that requires substantiation—a name alone is not proof of business dealings.

Days after registering as a For-Profit corporation, Taxpayer purchased an aircraft for $335,000. Taxpayer's corporate agent indicated at the hearing that he is active in many business enterprises and has been in business for many years. The agent further indicated that Taxpayer is affiliated with other businesses that agent operates. Such testimony confirms that Taxpayer's corporate agent is a knowledgeable and successful entrepreneur. As such, Department has to presume from the agent's statements that Taxpayer would promptly secure a Retail Merchants Certificate if leasing is to be the business enterprise.

As well, it is to be expected that Taxpayer also would promptly and diligently register the aircraft. But this did not happen. Taxpayer had to be prompted by the Department to register the aircraft—four months after purchasing it. It is fair to presume that the common Indiana citizen is aware that a vehicle is required to be registered—especially an aircraft that represents a major investment for a business. The Department has received no evidence as to why a corporate agent—who states he is a knowledgeable and successful business person—failed to secure a Retail Merchants Certificate in a timely manner. IC 6-2.5-8-1(b) imposes a modest $25 fee to obtain one. The six-month delay in obtaining a Retail Merchants Certificate and the four month delay in registering the aircraft are strong evidence that—despite the corporate name—Taxpayer was not diligent in establishing an intended purpose for the use of the aircraft as rental or leasing.

Taxpayer did secure a lease for the aircraft on May 28, 2002. At the time of the lease, Taxpayer had not registered the aircraft nor did Taxpayer have a Retail Merchants Certificate. This lease lasted for one year—terminating in June 30, 2003. The lease was terminated because Lessee stated that the aircraft was not being used enough to make it financially beneficial. An investigation of documentation provided by Taxpayer indicates that Lessee flew the aircraft infrequently. Documentation provided by Taxpayer also indicates that the aircraft was used by the corporate agent and Taxpayer's affiliated businesses several times after the purchase.

At the hearing, Taxpayer stated that the reason the aircraft was purchased was to lease it to Lessee. Taxpayer also stated that because of maintenance requirements, bad weather, and a downturn in the market for this type of aircraft, Taxpayer had a difficult time finding business. Taxpayer also stated that it attempted to sell the aircraft—to no avail. Taxpayer recently secured several possibly lucrative leases. But all of this is unpersuasive because the Department has requested Taxpayer to provide detailed documentation to substantiate the use of the aircraft. The hearing officer asked Taxpayer to provide a narrative marrying the assertions made by Taxpayer to the supporting documentation. This request was stated to Taxpayer at the hearing and a letter mailed after the hearing. Specifically, the Taxpayer was asked to provide documentation of the attempt to sell the aircraft. None was provided. The case file is replete with duplicate copies of documents. But the scattered pieces do not create a completed picture of Taxpayer's business intentions to lease.

A seasoned and experienced corporate agent would be diligent in securing necessary documentation and registrations so as to demonstrate business intentions. Taxpayer had to be prompted by the Department to register the aircraft—four months after the purchase. Additionally, Taxpayer claimed a sale/use tax exemption for rental or lease to others on the registration application, **Form 7695**—but did not supply a Retail Merchants Number to substantiate a claim for exemption. It was two more months before Taxpayer had a Retail Merchants Certificate—making it six months after the purchase of the aircraft before Taxpayer establishes any legal intention to attempt to lease or rent the aircraft. Form and substance work to complement each other in showing intention. Aircraft registration is required to be filed within 31 days after purchase. The reason for this time limit is to have Taxpayer declare the intention of a purchase contemporaneous to the purchase—not four or six months later. The General Assembly clearly and definitively has stated its intention concerning registration of aircraft and payment of sales/use tax. IC 6-2.5-9-6 states that the state may not register an aircraft unless the person obtaining the registration:

(1) presents proper evidence, prescribed by the Department of Revenue, showing that the sales/use taxes have been paid or that sales/use taxes are inapplicable because of an exemption; or

(2) files the proper form and pays the sales/use taxes due on the aircraft.

A person who purchases an aircraft is required to pay the sales/use taxes to the Department of Revenue. A person who knowingly fails to remit all or part of the sales/use taxes that are due commits a Class A misdemeanor. The form and proper evidence proscribed by the Department is Form 7695, **Application for Aircraft Registration or Exemption**.

While Taxpayer may have had an intention to lease the aircraft at some time after the purchase—Taxpayer was not able to lease the aircraft according to the revenue statutes promulgated by the General Assembly because Taxpayer had neither registered the aircraft nor obtained a Retail Merchants Certificate until prompted to do so. For the first six months, Taxpayer was operating the aircraft for its own use—as according to the tax statutes.

FINDING

Taxpayer's protest is denied

DEPARTMENT OF STATE REVENUE

42-20040273.LOF

LETTER OF FINDINGS NUMBER: 04-0273
IFTA
For The Period: 1999-2002

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

I. IFTA: Sufficiency of documentation

Authority: IFTA R1210.300; IC 6-8.1-5-1(b)

The taxpayer protests the proposed assessments; penalty and interest are also protested.

STATEMENT OF FACTS

The taxpayer is a contract hauler, hauling products provided by brokers. More facts will be provided as needed below.

I. IFTA: Sufficiency of documentation

DISCUSSION

In correspondence the taxpayer stated:

> I was leased to company's that withheld funds to pay fuel taxes all trip miles and driver logs were sent to company to settle weekly pay.

And the taxpayer stated, "[a]ll plates were purchased through company…." and further that "[w]hen leaving a company you had to turn in all permits & plates. I purchased plates in 2000 because [Company H] did not have plate program." Finally, the taxpayer states that it will "bring documentation to support" its contention that it "owe[s] no taxes." The taxpayer says it will "get copy's of leases fuel receipts and mileage reports."

Prior to the hearing date, the taxpayer faxed to the Department various documentation. Among the documents was a letter, dated September 9, 2004, from Company C which stated in part "[Taxpayer's] fuel tax was included in [Company C]'s Oklahoma IFTA returns for the periods 1/1/1999 through 12/31/2002." The letter does not indicate which trucks were purportedly covered, nor whether there was a lease agreement and what the terms of any lease were. Also among the faxed items was a "Lease Agreement" between the taxpayer and Company B (dated October 9, 2000). The faxed lease is only a portion, and does not appear to indicate who pays the taxes.

The taxpayer also faxed a copy of part of an "Independent Contractor's Lease Agreement" between it and Company H (lease dated March 20, 2000). The Auditor has already reviewed the March 20, 2000, lease. The Auditor took into account that since the lease specified a fuel tax chargeback, that Company H is assumed to bear the reporting responsibility. Thus the taxpayer has already received any credit for this specific issue and the submitted information has already been accepted.

On the day of the hearing the taxpayer also faxed to the Department a fax that he had received from Company B. The fax stated the following (from Company B):

> I am not aware of what type of contract you had with us, but whatever type of contract existed one of two things would have happened:
>
> 1. Deducted your portion of fuel taxes from your settlement and then paid these taxes on your behalf.
> 2. Agreed to pay your taxes and did not deducted them from your settlements.
>
> Either way, we would have paid your fuel taxes during your owner operator contract period with us.

Again, the same problems hold—the vehicles at issue are not specified, and the actual lease language is not shown.

Under IFTA R1210.300, in relevant part:

> The assessment made by a base jurisdiction pursuant to this procedure shall be presumed to be correct and, in any case where the validity of the assessment is questioned, the burden shall be on the licensee to establish by a fair preponderance of evidence that the assessment is erroneous or excessive.

And the Indiana Code 6-8.1-5-1(b) states in part:

> The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

The taxpayer has not met its burden of proof. The taxpayer also protested any "penalty or interest on the audit…." Taxpayer did not develop any argument regarding the penalty and interest, and is thus also denied regarding the penalty and interest.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040288.LOF

LETTER OF FINDINGS NUMBER: 04-0288
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred eighty four thousand, five hundred dollars ($284,500.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040289.LOF

LETTER OF FINDINGS NUMBER: 04-0289
Sales and Use Tax
For Tax Years 2002

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for four hundred ten thousand, seventy dollars ($410,070.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> > (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040290.LOF

LETTER OF FINDINGS NUMBER: 04-0290
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two hundred ninety two thousand, five hundred dollars ($292,500.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its renters to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040291.LOF

LETTER OF FINDINGS NUMBER: 04-0291
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-

27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one hundred seventy thousand dollars ($170,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040292.LOF

LETTER OF FINDINGS NUMBER: 04-0292
Sales and Use Tax
For Tax Years 2002 and 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of sales tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for four million, two hundred thousand dollars ($4,250,000) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate of one-thousand, nine-hundred and twenty-five dollars per hour ($1,925/hour), for the same type of aircraft, to the five-hundred dollars per hour ($500/hour) rate taxpayer charged for its aircraft. The signatory for both lessee and lessor on the leasing agreement were the same individual, and the rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Taxpayer paid sales tax on the initial lease payment by its customer, but filed "zero" sales/use tax returns from May 2002 to November 2002 and failed to file any return at all for December 2002 and January 2003. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. Taxpayer's customer reported that it used the aircraft three or four times, which the Department considered insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The only rentals or leasing the Department learned of was three times to taxpayer's only customer. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Taxpayer states that it was formed for the purpose of leasing the aircraft to charter companies and, since the charter companies would have been exempt from paying sales tax on the aircraft had they purchased it directly, that there is no tax savings involved in the transaction. The Department notes that taxpayer has not provided documentation establishing that its customer was in fact tax-exempt. Also, the Department has not received documentation establishing that the aircraft was leased or rented to any other parties. As determined by reviewing all documentation submitted to the Department, the aircraft was leased to one customer who used the aircraft a total of three or four times. Taxpayer has not provided any other documentation concerning the use of the aircraft.

The aircraft cost $4.25 million dollars and the only lease/rental activity mentioned, let alone documented, is the three uses of the aircraft by the customer. Again, 45 IAC 2.2-5-15 requires a taxpayer to be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Taxpayer clearly does not qualify for this exemption. Taxpayer's claim that there are no tax savings under its arrangement is incorrect.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. It is worth noting that the amount the Department used as a reference rental rate by a third party for a similar aircraft ($1925) did not include a pilot and copilot in that rental agreement. For the plane with a pilot and copilot, the third party charged two thousand, four hundred dollars an hour ($2400/hour).

45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320040293.LOF

LETTER OF FINDINGS NUMBER: 04-0293
Withholding Tax
Responsible Officer
For the Tax Period 1989-1991

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.

ISSUE

1. Withholding Tax-Responsible Officer Liability

Authority: IC 6-3-4-8(f), IC 6-8.1-5-1(b), Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995), Ball v. Indiana Department of Revenue, 563 N.E. 2nd 522 (Ind. 1990).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate withholding taxes.

STATEMENT OF FACTS

The taxpayer was an officer of a corporation that did not properly remit withholding taxes to the state during the tax period 1989-1991. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed the unpaid withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995) any officer, employee, or other person who has the authority to see that they are paid has the statutory duty to remit sales and withholding taxes to the state. The taxpayer agreed at the hearing that he had the responsibility to oversee the corporation and see that the withholding taxes were remitted to the state. Therefore, the taxpayer had the statutory duty to remit the sales taxes and is personally liable for the payment of those taxes.

The taxpayer contends that he made a good faith effort to remit the taxes to the state twelve years ago when the business was closed. The department has no records, however, of any payments on the liabilities in question. The taxpayer was not able to present any documentation to prove that the taxes had been paid. The taxpayer did not meet his burden of proving that the withholding taxes had already been paid and are not owing at this time.

The taxpayer also argues that pursuant to the doctrine of laches, the department's delay in personally assessing the taxes against him bars the department from collecting the subject withholding taxes from him now. The Indiana Supreme Court held in Ball v. Indiana Department of Revenue, 563 N.E. 2nd 522 (Ind. 1990) at page 522 that laches would apply only if the department had acted "in an unusually dilatory manner." In this case, the transfer of the liability to the responsible officer was made in the normal course of the department's operations. The taxpayer presented no evidence that the department acted in an unusually dilatory manner in this case. Therefore laches does not bar this assessment against the taxpayer.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040331.LOF

LETTER OF FINDINGS NUMBER: 04-0331
Responsible Officer Liability—Duty to Remit Sales Tax
Penalty—Request for Waiver
For Tax Year 2001

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

I. Responsible Officer Liability—Duty to Remit Sales Tax

Authority: IC § 6-2.5-2-1; IC § 6-2.5-9-3; 45 IAC 2.2-2-2; 45 IAC 2.2-9-4; *Indiana Department of Revenue v. Safayan,* 654 N.E.2d 270, 273 (Ind. 1995)

Taxpayer protests the Department's determination of responsible officer liability for sales tax not paid during the assessment period.

II. Penalty—Request for waiver

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of the 10% negligence penalty and requests a waiver.

STATEMENT OF FACTS

Taxpayer protests the Department's determination of responsible officer liability, based on the following facts. Taxpayer incorporated the business, whose gross retail tax liability is at issue, in 1993. Taxpayer claims to have resigned as an officer of the corporation in 1996 when all shares in the company were sold to a third party who dissolved the corporation in 2003. Additional facts will be supplied as necessary.

I. Responsible Officer Liability—Duty to Remit Sales

A gross retail (sales) tax is imposed on retail transactions made in Indiana. While this sales tax is levied on the purchaser of retail goods, it is the retail merchant who must "collect the tax as agent for the state." *See*, IC § 6-2.5-2-1 and 45 IAC 2.2-2-2.

Individuals may be held personally responsible for failing to remit any sales tax. In determining who may acquire personal liability, IC § 6-2.5-9-3 is applicable:

An individual who:

(1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and

(2) has a duty to remit state gross retail or use taxes (as described in IC § 6-2.5-3-2) to the department;

holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes to the state.

See also, 45 IAC 2.2-9-4.

In order to determine which persons are personally liable for the payment of these "trust" taxes, the Department must initially determine which parties had a duty to remit the taxes to the Department. *Indiana Department of Revenue v. Safayan*, 654 N.E.2d 270, 273 (Ind. 1995) is instructive:

The method of determining whether a given individual is a responsible person is the same under the gross retail and the withholding tax…. An individual is personally liable for unpaid sales and withholding taxes if she is an officer, employee, or member of the employer who has a duty to remit the taxes to the Department…. The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that the taxes are paid.

The Indiana Supreme Court in *Safayan* identified three relevant factors:

(1) the person's position within the power structure of the corporation;

(2) the authority of the officer or employee as established by the articles of incorporation, bylaws, or the person's employment contract; and

(3) whether the person actually exercised control over the finances of the business.

The Supreme Court also stated in *Safayan* that "where the individual was a high ranking officer, we presume that he or she had sufficient control over the company's finances to give rise to a duty to remit the trust taxes." Id. at 273. The Department further notes that *Safayan* specifically rejects the defense of failure by an officer to exercise oversight.

Taxpayer has provided documents showing that taxpayer did indeed resign from the corporation as an officer in 1996, along with the other officers, who then sold all shares in the business to a third party.

The Department finds that taxpayer has provided sufficient evidence to overturn the Department's initial determination of responsible officer liability.

FINDING

Taxpayer's protest concerning the Department's determination of responsible officer liability for unpaid gross retail taxes is sustained.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty on the assessment. Since the Department has sustained taxpayer's protest on the merits, the penalty protest has been rendered moot.

DEPARTMENT OF STATE REVENUE

0420040349.LOF

LETTER OF FINDINGS NUMBER: 04-0349
Sales and Use Tax
For Tax Years 2003

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for one million, three hundred twenty eight thousand, four hundred fifty dollars ($1,328,450.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

> (4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. The rental rate was set far below the fair market rate. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid

lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040404.LOF

LETTER OF FINDINGS NUMBER: 04-0404
Sales and Use Tax
For Tax Years 2004

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.

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-2-1; IC 6-2.5-5-27; IC 6-6-6.5-9; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft for two million, fifty thousand dollars ($2,050,000.00) and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. Taxpayer's rental rate was far below the market rate. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer offers several arguments in support of its claim for the exemption. First, taxpayer refers to IC 6-6-6.5-9(a)(4), which states:

(a) The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;

…

(4) An aircraft owned or operated by a person who is either an air carrier certified under Federal Air Regulation Part 121 or a scheduled air taxi operator certified under Federal Air Regulation Part 135, unless such person is a corporation incorporated under the laws of the state of Indiana or an individual who is a resident of Indiana.

Taxpayer states that IC 6-6-6.5-9(a)(4) provides that an aircraft owned or operated by a person who is either an air carrier certificated under Federal Air Regulation Part 121 or an air taxi operator certified under Federal Air Regulation Part 135, is exempt to state sales and use tax. Taxpayer is incorrect.

As plainly stated in IC 6-6-6.5-9(a), "The provisions of this chapter pertaining to registration and taxation shall not apply to any of the following;". The chapter referred to is chapter 6.5 of article 6 of title 6 of the Indiana Code. Chapter 6.5 of article 6 of title 6 deals with aircraft license excise tax. IC 6-6-6.5-9(4) only applies to aircraft license taxes, not the sales tax which is the tax at issue in this protest. Therefore, taxpayer's reliance on that subsection is misplaced.

The sales tax is established at IC 6-2.5-2-1, which states:

(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.

Sales tax is due on retail transactions, such as the purchase or rental of an aircraft. Neither taxpayer nor its customer provided documentation establishing exempt use of the aircraft. The Department considered this insufficient to prove that the aircraft was used for renting or leasing. The Department never received any documentation establishing that any other third party used the aircraft. This contributed to the Department's determination that taxpayer was not renting or leasing the aircraft.

Taxpayer also refers to the Internal Revenue Code and a Revenue Procedure issued by the Internal Revenue Service. Taxpayer asserts that the lease was necessary to conform to both Federal Aviation Regulations and the Revenue Procedure. Taxpayer offers no detailed explanation beyond the bare assertion that the lease was necessary. Taxpayer fails to explain why setting the rental rate at a fraction of the rates charged by other rental businesses was necessary. The Department is unconvinced by this assertion.

Next, taxpayer refers to IC 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Taxpayer claims that this exemption applies to its purchase of the aircraft.

By taxpayer's own explanation, it did not directly use the aircraft in providing public transportation. Taxpayer states that it rented to another business which in turn provided public transportation. The exemption, if applicable at all, would apply to taxpayer's customer since it is the one claiming to directly use the aircraft in public transportation. Therefore, the exemption found in IC 6-2.5-5-27 is not applicable to taxpayer.

Next, taxpayer states that the aircraft was used for rental to others, and therefore was exempt from sales tax under 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.

Taxpayer states that it was in the business of leasing aircraft and therefore qualifies for the exemption provided by 45 IAC 2.2-5-15. 45 IAC 2.2-5-15(b) requires that three conditions be met in order to qualify for the exemption. One condition is 45 IAC 2.2-5-15(b)(2) states that the purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. The Department notes that the same individual signed the leasing agreement as lessor and as lessee. Also, the Department has not received any documentation establishing that taxpayer's leasing business ever showed a profit. While profitability of a business is not normally germane as to the existence of a true lessor/lessee relationship, in this case it does indicate that taxpayer had arranged for its two owner/renter parties to pay much less than a fair market value for the rental of the aircraft. The rental at issue here was not an arms-length transaction. Under these circumstances, taxpayer does not satisfy 45 IAC 2.2-5-15-(b)(2) and does not qualify for the leasing exemption.

Next, taxpayer explains that its customer paid a lower lease rate because it was paying other expenses which, when added to the lease rate, brought the total customer paid closer to comparable lease rates. Taxpayer explains that, under the "dry lease", the lessee was responsible for paying expenses such as insurance, hangar, fuel, maintenance and crew. This supposedly brought the leasing costs to appropriate levels. 45 IAC 2.2-4-27(d) states in relevant part:

The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

…

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is further evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship.

Next, taxpayer states that it only created the leasing corporation in order to avoid liability in the event of a catastrophic loss. Taxpayer explained that it was difficult if not impossible to purchase enough insurance to cover potential liabilities from a crash, so it created the lessee corporation to shelter the lessor corporation from those potential liabilities. While this may or may not be the case, it is ultimately irrelevant since it does not explain why the rental rate was set at a fraction of the rate charged for comparable aircraft in the area. The fact that the rental rate was so low makes it plain that the rental agreement was set up to avoid sales tax, since the rental rate would have nothing to do with potential liabilities from a crash.

Finally, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp.

Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, taxpayer's reference to IC 6-6-6.5-9(a)(4) is inapplicable since it deals with aircraft licensing tax rather than sales tax. Neither Federal Air Regulations nor the Internal Revenue Code made it necessary for taxpayer to set its rental rates at a fraction of the fair market rental rate. Taxpayer was not directly providing public transportation and was not eligible for the exemption described in IC 6-2.5-5-27. Taxpayer was not occupationally engaged in renting to others and does not qualify for the exemption found in 45 IAC 2.2-5-15. It is irrelevant if the leasing corporation was formed to shield taxpayer from liability in the event of a crash, since that would have no influence on the rental rate. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew, as required by 45 IAC 2.2-4-27(d). Taxpayer's relationship with its customer was too close and the terms of the rental agreement too generous to establish an arms-length business relationship. The rental/lease arrangement between taxpayer and its customer constitutes a "sham transaction" entered into for the sole purpose of avoiding taxes, as established in Gregory v. Helvering. Without a valid rental/lease agreement, taxpayer is ineligible for the rental exemption on the purchase of the aircraft.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320040450P.LOF

LETTER OF FINDINGS NUMBER: 04-0450P
Withholding Tax
For the month of March 2004

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.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2;

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of a monthly withholding tax return for the month of March 2004.

The taxpayer is a company residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be abated as the taxpayer made a reasonable assumption. Since the taxpayer was filing quarterly in other states, the taxpayer assumed the filing for Indiana would be quarterly.

The Department let it be known upon the taxpayer's registration that early filing status was prompted by the amount of the taxpayer's withholding. Furthermore, the mailing labels were sent to the taxpayer the next day after the taxpayer registered.

45 IAC 15-11-2(b) 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 finds the taxpayer was ignorant of its tax duties. Ignorance is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0320050032P.LOF

LETTER OF FINDINGS NUMBER: 05-0032P
Withholding Tax
For the Calendar Year 2002

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.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2;

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late filing of W-2 forms for the calendar year 2002.

The taxpayer is a company residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the error was unintentional.

The taxpayer states all W-2 and WH-18 forms were processed by the due date. All forms were placed in the mail for delivery by the due date. It was discovered after mailing that the state copies of W-2 forms were not included with form WH-18 in the original mailing. As such, the taxpayer made a second mailing with copies of the W-2 and WH-18 forms.

The Department points out the W-2s and WH-18 were received one month late.

45 IAC 15-11-2(b) 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 finds the taxpayer was inattentive of tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0320050088.LOF

LETTER OF FINDINGS NUMBER: 05-0088
Withholding Tax
Responsible Officer
For the Tax Period 1998-1999

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.

ISSUE

1. Withholding Tax-Responsible Officer Liability

Authority: IC 6-8.1-5-1(b), IC 6-3-4-8(f).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate sales taxes.

STATEMENT OF FACTS

The taxpayer was the trustee of a trust which was an investor in a corporation that did not remit the proper amount of sales taxes during the tax period 1998-1999. The Indiana Department of Revenue assessed the unpaid sales taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

The taxpayer produced substantial documentation that he had no duty to collect and remit the withholding taxes to the state. Therefore, he is not personally responsible for the payment of the corporate withholding taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120040311.LOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 04-0311
Individual Income Tax
For the Year 2001

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.

ISSUE

Individual Income Tax—Assessment

Authority: IC 6-8.1-5-1(a), (b), (c).

Taxpayer protests the assessment of individual income tax.

STATEMENT OF FACTS

Taxpayer filed an IT-40 for the year ending 2001, which listed no income. A cross-match with the federal return indicated income. The Department mailed to Taxpayer a Proposed Assessment and a Demand Notice for Payment. Taxpayer mailed a protest letter to the Department stating that they do not agree with the proposed amount. A hearing officer was assigned to hear the protest and mailed a letter informing Taxpayer of the hearing date. Taxpayer did not show for the tax protest hearing and a Letter of Findings was written based on the information in Taxpayer's case file. Taxpayer requested a rehearing and one was granted. Taxpayer was mailed a certified letter stating the date and time of the rehearing. A return receipt was received with Taxpayer's signature upon it. The Hearing Officer also phoned and spoke with Taxpayer—to inform them of the date and time of the rehearing. Taxpayer also did not show for the rehearing. Taxpayer did mail a certified letter containing their basis for the tax protest. That letter was included in Taxpayer's case file. This Supplementary Letter of Findings was written based on the information in Taxpayer's case file.

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). If the Department reasonably believes that a person has not reported the proper amount of tax due, the Department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the Department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC 6-8.1-10 concerning the imposition of penalties and interest. The Department shall send the person a notice of the proposed assessment through the United States mail. IC 6-8.1-5-1(a). The notice shall state that the person has sixty (60) days from the date the notice is mailed to pay the assessment or to file a written protest. If the person files a protest and requests a hearing on the protest, the Department shall:

(1) set the hearing at the Department's earliest convenient time; and

(2) notify the person by United States mail of the time, date, and location of the hearing.

IC 6-8.1-5-1(c).

The Department has followed the statutes and has provided Taxpayer with the opportunity to be heard at a hearing and also at a rehearing—which Taxpayer has chosen not to attend both times. Based on the information and evidence in Taxpayer's case file, the Department finds the assessment to be accurate. No credible evidence to rebut the accuracy of the assessment was provided by Taxpayer. Taxpayer has made references to the Internal Revenue code, Indiana statutes, and United States Supreme Court cases that since have been overruled. None of these are convincing to rebut the presumption of the accuracy of the assessment. Taxpayer has cited Indiana statutes and regulations permitting access to public records. This has no bearing upon rebutting the accuracy of the assessment.

FINDING

Taxpayer's protest is denied. The assessment of individual income tax is due. Penalties and interest are due.

DEPARTMENT OF STATE REVENUE
Indiana Department of State Revenue
Revenue Ruling #2005-03ST
March 2, 2005

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.

ISSUE

Sales and Use Tax-Imposition

Authority: I.C. 6-2.5-3-2(a), I.C. 6-2.5-1-2, I.C. 6-2.5-1-2, I.C. 6-2.5-4, I.C. 6-2.5-4-1(b), I.C. 6-2.5-4-1(d), I.C. 6-2.5-4-2(b)(1), I.C. 6-2.5-4-2(b)(1), I.C. 6-2.5-5-5-8, I.C. 6-2.5-2-1.

Taxpayer requests that the department rule on the proper treatment of Taxpayer and the concerns with which Taxpayer conducts business for Indiana state gross retail ("sales") and use tax purposes.

STATEMENT OF FACTS

Taxpayer is a corporation providing an online shopping and information service to the general public, electronically linking consumers and local retailers. A member of the general public ("Customer") wishing to use the service must register with the taxpayer. There is no charge for registration or use of the service.

A local Retailer's listing on the taxpayer's website is free and includes a free web-link to the Retailer's e-commerce website. A retailer may, in addition to receiving a free basic listing, sign up for enhanced listing features (e.g., listing in bold or red letters), advertising, the creation and maintenance of an e-commerce website by Taxpayer, and to provide free delivery service by a Deliverer for orders over an amount ("Breakpoint") determined by the retailer.

Upon accessing the website maintained by Taxpayer, a Customer encounters a "Mall Directory", which contains a listing of the various categories of products that may be ordered as well as advertising. Clicking on a category, e.g., "Books", leads to a "Books Main Street", which lists local Retailers (Borders, Barnes & Noble, etc.) from which books may be ordered. Clicking on a listed Retailer, in turn, typically takes the Customer to the Retailer's e-commerce website, where the customer can review the inventory and select the item(s) to be purchased. Upon completion of shopping, the Customer sends an order to Taxpayer, which, in turn, sends the order via internet to a Deliverer close to the Customer and the Retailer from which items are ordered. A Customer is free to request the services of a particular Deliverer, subject to availability.

Deliverers are independent contractors, often housewives or single mothers that are engaged in the business of providing personal shopping, fulfillment and courier services for Customers. Taxpayer anticipates that there will be approximately 125 Deliverers providing services in the area.

A Deliverer who receives notice of an order from Taxpayer is free to accept or reject the order. If rejected, Taxpayer sends the order to another Deliverer, and so on, until the order is accepted. A Deliverer who accepts an order drives to the Retailer and purchases the items ordered on behalf of the Customer, paying the Retailer the retail price of items purchased plus applicable sales tax. The Deliverer may call or e-mail the Customer from the Retailer's location and suggest an alternative to an item ordered if the item is out of stock, if a similar item is on sale, etc. The Deliverer then delivers the order to the Customer along with the original sales receipt from the Retailer.

Customers only make payments to Deliverers. Customers make no payments to Taxpayer, nor do they make payments to Retailers. Typically a Customer pays a Deliverer: (a) reimbursement for the price of the items (including applicable sales tax) which the Deliverer purchased on the Customer's behalf; (b) a fee for the Deliverer's services; and (c) a tip (optional).

Deliverers receive the following payments from Customers: (a) reimbursements for the retail price of items purchased (including sales tax) on behalf of the Customers; (b) fees for their services (Delivery Fees); and (c) tips. In addition, Deliverers receive payments for their services from Retailers who sign up to advertise for free Deliverer service on Taxpayer's website. A general retail Free Service Retailer pays a Deliverer an amount equal to 10% of the retail price of items on orders below the breakpoint, and that amount plus a Delivery Fee of $4.95 on orders at or above the Breakpoint.

All Retailers only receive payment for items that Deliverers purchase on behalf of Customers from the Deliverers. All Retailers collect sales tax on the full retail price of items which Deliverers purchase on behalf of Customers.

Taxpayer, the Deliverers and the Customers view the business as a personal shopping service. What Customers desire, and what they get, is a personal valet to perform shopping services.

Deliverers do not maintain any stock of goods, do not hold themselves out as merchants, pay applicable sales tax on the price of items purchased from Retailers on behalf of Customers, and provide Customers with the original sales slip on all purchases. Furthermore, Deliverers do not "mark-up" the Retailers' price of such items, and only receive reimbursement from Customers for the retail price of items (including tax) purchased for the Customers.

DISCUSSION

I.C. 6-2.5-2-1(a) imposes sales tax on retail transactions made in Indiana. I.C. 6-2.5-3-2(a) imposes use tax on the storage, use or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction as defined for sales tax purposes, regardless of the location of that transaction. A "retail transaction" is defined in I.C. 6-2.5-1-2 as a transaction that constitutes "selling at retail", a "wholesale sale"' or that is otherwise described as a transaction that is otherwise described in I.C. 6-2.5-4. These provisions impose sales and use tax on certain defined services. None of those services, however, include the type of personal shopping and fulfillment services provided by the Taxpayer or the Deliverer.

I.C. 6-2.5-4-1(b) states that a person is engaged in "selling at retail" when:

In the ordinary course of his regularly conducted trade or business, he:

(1) Acquires tangible personal property for the purpose of resale; and

(2) Transfers the property to another for consideration.

A person is not selling at retail if making a "wholesale sale". I.C. 6-2.5-4-1(d). A person is making a "wholesale sale: when he "sells tangible personal property... to a person who purchases the property for the purpose of reselling it without changing its form." I.C. 6-2.5-4-2(b)(1).

I.C. 6-2.5-5-5-8 provides that transactions involving tangible personal property are exempt from tax "if the person acquiring the property acquires it for resale... in the ordinary course of the person's business without changing the form.

Indiana sales of tangible personal property are subject to the Indiana sales tax unless they qualify for a statutory exemption. The sellers of the property are required to collect the sales tax from the purchasers and remit that tax to the state. I.C. 6-2.5-2-1.

I.C. 6-2.5-8-8 provides for exemption certificates from sales tax in pertinent part as follows:

> (a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

In the fact situation submitted by the Taxpayer, the retail transaction or transfer of tangible personal property for consideration is between the Retailer and the Customer. The Customer purchases an item such as a sweater or book from the Retailer. The sales tax is properly imposed on this transaction. The Retailer has the statutory duty to collect the sales tax from the Customer or his agent and remit the sales tax to the state unless the transaction or use of the item qualifies for a statutory exemption. If the Retailer receives a valid exemption certificate from the Customer, the Retailer is relieved of the duty to collect and remit the sales tax.

The Taxpayer does not transfer any tangible personal property for consideration in a retail transaction. Rather, it provides services. It provides advertising opportunities to Retailers. It allows Customers to use its services and website. It facilitates retail sales by connecting Customers with Retailers. It connects Customers with Deliverers. None of these services are listed as a taxable service in the statute. The Taxpayer does not engage in retail transactions.

The Deliverers provide personal shopping and fulfillment services. These are not services defined as taxable services in the statute. The Deliverers do not buy items in a wholesale sale and resell it to the Customers. The Deliverers act as agents for the Customers in their transactions with the Retailers. The Deliverers step into the shoes of the Customers. Deliverers receive specific directions from Customers as to exactly which item to purchase, where to purchase the item, and the price to pay for the item. If any change is necessary, the Deliverer calls the Customer to receive specific authority to make the change in item, cost, or location of purchase. The Deliverer pays for the item and accepts title on behalf of the Customer who reimburses the Deliverer. The fee paid to the Deliverer for picking up and delivery of the item is not subject to sales tax.

Customers directly reimburse the Deliverers for the consideration and sales tax paid. Any additional fees such as delivery charges and tips are for the non-taxable personal shopping service.

This nontaxable delivery fee is distinguishable from a situation where the delivering party is not the true agent of the buyer. An example of a taxable delivery fee would be a buyer wishing to buy gravel. The purchaser would call a trucking company which would obtain the gravel and deliver it to the buyer. In that taxable situation, the trucking company would have the freedom to choose the retailer from whom to buy the gravel. The trucking company is an independent contractor, not the true agent of the buyer.

RULING

1. Taxpayer has no sales or use tax obligations in connection with Customers' use of its service or website, Deliverers' provision of services to Customers, or Deliverers' purchases from Retailers on behalf of Customers.

2. Deliverers are obligated to pay sales tax to Retailers on the retail price of taxable tangible personal property which Deliverers purchase from Retailers on behalf of Customers.

3. Deliverers who make purchases on behalf of exempt organization Customers may, if authorized to do so by such Customers,

issue exemption certificates for purchases made on behalf of the Customers.

4. Deliverers are not obligated to collect sales or use tax on the amounts received from Customers as reimbursements for amounts paid to Retailers in purchasing items on behalf of the Customers, on Delivery Fees, or on tips.

5. Retailers are obligated to collect sales tax on the retail price of all taxable tangible personal property sold to Deliverers on behalf of customers, but are not obligated to collect sales or use tax on amounts which Deliverers receive from Customers.

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 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.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2005-04ST
March 22, 2005

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.

ISSUE

Sales and Use Tax-Imposition

Authority: IC 6-2.5-2-1, IC 6-2.5-1-2, IC 6-2.5-4-1, IC 6-2.5-3-4(a), IC 6-2.5-3-2, IC 6-2.5-3-6, Black's Law Dictionary, Sixth Edition, West Publishing Company, 1990, at page 63.

The taxpayer requests that the department rule on the application of Indiana sales and use tax to its Indiana activities in procuring goods and services from third-party vendors necessary for the operation of the property being managed by the taxpayer.

STATEMENT OF FACTS

The taxpayer is an out of state corporation with offices in Indiana and throughout the country. The taxpayer performs property management services in Indiana for owners and occupiers of commercial real estate in Indiana. For each client engagement, the taxpayer operates under one of two types of arrangements, as determined by marketplace conditions:

1. IC Engagement: In an IC Engagement, the taxpayer operates as an independent contractor under a Facilities Management Agreement. Unless expressly stated, the taxpayer does not operate with express agency authority from the client in an IC Engagement.

2. Agency Engagement: In an Agency Engagement, the taxpayer acts as an agent for the client under an express grant of authority given in the Property Management Agreement entered into between the taxpayer and the client.

In the normal course of a property management engagement, whether an IC Engagement or an Agency Engagement, the taxpayer procures all goods and/or services from third-party vendors necessary to operate the properties being managed for a particular client. Examples of such goods and services include: landscaping services; washroom supplies; and elevator maintenance services. The goods and services provided by third-party vendors are provided directly to a specific client's property for immediate use on that property to satisfy an immediate need. The third-party provided goods are never held as inventory of the taxpayer for use at a later time, or for performing property management services for any of its other clients. The taxpayer never takes title to or possession of any goods provided by third-party vendors.

The taxpayer receives invoices for these goods and services from the third-party vendors, and presents the invoices to the subject client for approval. All invoices include applicable retail sales and use taxes. Once an invoice is approved, the client deposits funds into a segregated bank account. The taxpayer is authorized to withdraw funds to pay the total amount of the invoice including all applicable retail sales and use taxes. The taxpayer does not pay the vendors using taxpayer's funds. The third-party vendor and the taxpayer agree that the vendor will only be paid from funds deposited by the client into the segregated bank account. Further, the third-party vendor and the taxpayer agree that the taxpayer will have no liability in the event of non-payment by the client.

For both IC Engagements and Agency Engagements, the third-party vendor determines the applicable retail sales and use tax for each invoice, and adds that tax to the invoice. The tax is paid when the full amount of the invoice is paid from the segregated bank account. The vendor remits the tax as part of its usual monthly sales and use tax procedures. The taxpayer's role is to oversee the payment of applicable retail sales and use taxes as part of the payment of vendor invoices from the segregated account. All retail sales and use taxes applicable to the goods and services provided by third-party vendors are collected and remitted in the appropriate amount and time.

The taxpayer does not charge or otherwise receive any sort of mark-up on the goods and services procured on behalf of the client. The taxpayer's value is added solely in the management of the client's property and the timely ascertainment of the need for particular goods or services for the operation of that property. The taxpayer receives no compensation from its clients based on its inventory distribution and maintenance services as would a wholesaler or retailer in a traditional supply chain. Whether the property management engagement is an IC Engagement or an Agency Engagement, the taxpayer's value is in the oversight, coordination, and procurement of vendor-provided goods and services that are found to be needed for the particular property and particular client.

The only differentiating feature between IC Engagements and Agency Engagements is the way that a third-party vendor makes its contract. In an IC Engagement, the third-party vendor makes its contract directly with the taxpayer. In an Agency Engagement, due to the express agency the taxpayer obtains from its client, the third-party vendor makes its contract with the taxpayer as agent for the taxpayer's client. All of the attributes summarized in the preceding paragraphs are the same with either an IC Engagement or an Agency Engagement.

In return for its property management service, the taxpayer is compensated through a monthly management fee, upon which the taxpayer pays all applicable taxes including any applicable sales tax.

DISCUSSION

The Indiana sales tax is imposed on tangible personal property and/or taxable services acquired in a retail transaction for which a total combined charge or selling price is calculated. The consumer is liable for payment of the sales tax and must pay the tax to the retail merchant as a separately added amount to the sales price. The seller remits the tax to the state. IC 6-2.5-2-1. A "retail transaction" is "a transaction of a retail merchant that constitutes selling at retail." IC 6-2.5-1-2. A retail merchant is selling at retail when the merchant sells or provides a taxable service in the ordinary course of his business for consideration to another person. IC 6-2.5-4-1.

The Indiana use tax is an excise tax imposed on the storage, use, or consumption of tangible personal property in Indiana that was acquired in a retail transaction, regardless of the location of the transaction or the retail merchant making the transaction. IC 6-2.5-3-2. The use tax is not due if the sales tax was paid on the transaction or the use of the property is eligible for a statutory exemption. IC 6-2.5-3-4(a). Purchasers/ consumers of property or services that are subject to use tax must pay the tax to the seller, if the seller has sufficient contacts with Indiana to compel use tax collection. Otherwise, the purchaser/consumer must self assess the tax and remit it directly to the Indiana Department of Revenue. IC 6-2.5-3-6.

The taxpayer argues that it will be acting in the capacity of an agent for the clients in the purchasing of supplies and services for the clients. The term "agent" is defined in Black's Law Dictionary, Sixth Edition, West Publishing Company, 1990, at page 63 as, a "person authorized by another (principal) to act for or in place of him; one entrusted with another's business."

In both the IC and Agency agreements, the clients give clear and written consent to the taxpayer to act on their behalf. The taxpayer holds itself out as an agent in their dealings with the providers of supplies and services to the third-party vendors. The taxpayer has no right, title, or interest in the property and services purchased for clients. Nor does the taxpayer have any right, title, or interest in the money used to pay for the supplies and services. The money passes intact from the clients to the third-party vendors. The taxpayer acts in the stead of its clients and is entrusted with their business. In these situations, the taxpayer is a true agent concerning the procurement of supplies and services for its clients.

Because the taxpayer as a true agent is transacting the business of the clients, the transactions do not constitute sales for resale from the third-party vendors to the taxpayer. Rather, the sales of goods and services are between the third-party vendors and the taxpayer's clients. The clients must pay the sales or use tax. The third-party vendors must collect and remit the taxes.

RULING

1. The taxpayer is the true agent of the clients in the procurement of supplies and services.
2. The transactions between the third-party vendors and the taxpayer's clients are direct retail sales by the third-party vendors to the taxpayer's clients.
3. The transactions between the third-party vendors and the taxpayer's clients do not constitute sales for resale to taxpayer.
4. The taxpayer does not need to register as a retail merchant or issue exemption certificates on the sales.
5. If the third-party vendor does not have sufficient nexus, the taxpayer's clients must self assess and pay the use tax directly to the state.

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 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.