DEPARTMENT OF STATE REVENUE
AUDIT-GRAM NUMBER IR-027
January 6, 2006

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ISSUE: Cleaning Compounds Used in Manufacturing

Authority: IC 6-2.5-5-5.1(b); IC 6-2.5-5-3; 45 IAC 2.2-5-12; 45 IAC 2.2-5-8(d); *Guardian Automotive*, Ind. Tax Ct., 2004

IC 6-2.5-5-5.1 Exemption; acquisition for direct consumption in direct production…

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing. *As added by Acts 1981, P.L.63, SEC.6. Amended by P.L.23-1986, SEC.2; P.L.78-1989, SEC.5; P.L.192-2002(ss), SEC.51*

I. General Statement

Cleaning compounds, integrated into a manufacturing process, which are not part of a regular maintenance program and would, if not used, have a negative impact on the product produced, are exempt from the Gross Retail Tax.

II. Production

To avail themselves of the exemption, taxpayers must be engaged in the production of a marketable good. Production requires a "substantial" change or transformation that "places tangible personal property in a form, composition, or character different from that in which it was acquired." [FN 1]

III. Essential and Integral

The item for which exemption is requested must be closely connected with the production of goods. It is not necessary that the item have a transformation effect on the good being produced. It is sufficient that the item has an integral part in the ongoing process of transformation. [FN 2] The item must play an essential part in ensuring the production of a marketable good.

[FN 1] 45 IAC 2.2-5-8(k)
[FN 2] *Guardian Automotive Trim, Inc.*, Indiana Tax Court, 2004

DEPARTMENT OF STATE REVENUE

02990598.LOF

LETTER OF FINDINGS NUMBER: 99-0598
Income Tax
For Tax Years 1995-1997

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ISSUE

I. Adjusted Gross Income Tax—Unitary Status

Authority: IC 6-3-2-2

Taxpayer protests the Department's determination that it was not eligible to file a combined return with affiliated companies.

STATEMENT OF FACTS

Taxpayer operates several movie theaters in Indiana and other states. The Indiana Department of Revenue ("Department") determined that taxpayer was not eligible to file a combined return with several affiliated companies. The Department issued proposed assessments for taxpayer as a single filer. Taxpayer protests this determination. Further facts will be supplied as required.

I. Adjusted Gross Income Tax—Unitary Status

Taxpayer protests the adjustment disallowing the filing of a combined return and assessing taxpayer as a single filer. Taxpayer states that it received permission to include a total of eleven companies from the Department in a Revenue Ruling. The Revenue Ruling explained that, based on the information available at the time, permission was granted to file a combined return. The Revenue Ruling also stated that the permission was conditional on the accuracy of the facts and that, if it was determined that the stated facts were inaccurate, permission could be revoked.

As the result of an audit, the Department determined that the facts did not warrant filing a combined return. Most significantly, the Department determined that nine of the eleven corporations included in the combined return had no nexus with Indiana. Also, the nine non-nexus corporations all had losses for the years in question, while the two nexus corporations had positive income for those years. By including the nine non-nexus corporations and including losses which occurred outside Indiana, taxpayer was able to offset the income it made in Indiana. The Department adjusted taxpayer's return to reflect filing as a single filer.

Taxpayer protests this adjustment and states that it meets all unitary criteria and is therefore a unitary group according to IC 6-3-2-2. The Department notes that IC 6-3-2-2 does not provide a definition of a unitary group, however the relevant subsection is IC 6-3-2-2(q), which states:

Notwithstanding subsections (*o*) and (p), one (1) or more taxpayers may petition the department under subsection (*l*) for permission to file a combined income tax return for a taxable year. The petition to file a combined income return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

Therefore, IC 6-3-2-2(q) relies on IC 6-3-2-2(*l*), which states:

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.

Reading these two subsections together, a taxpayer may petition the Department to file a combined return if the apportionment provisions of IC 6-3-2-2 do not fairly represent a taxpayer's income derived from sources within the state of Indiana. The use of the phrase "may petition" in IC 6-3-2-2(*l*) means that the Department is not compelled to use the alternative methods provided. The Department notes that it would not fairly represent taxpayer's income derived from sources within the state of Indiana if taxpayer were to include companies which have no nexus to Indiana, no Indiana taxable income and non-Indiana related losses. The inclusion of these companies serves no other purpose than to dilute Indiana income earned by the two Indiana-nexus companies. This would not fairly represent taxpayer's income derived from sources within the state of Indiana, therefore use of any of the alternative methods provided in IC 6-3-2-2(*l*) is not reasonable.

Taxpayer also protests the wording in the audit report. Taxpayer refers to the auditor's listing of the non-nexus companies as, "…*a* movie theater…one owns a traffic signal…one operated *a* pizza restaurant…" and states that there is no requirement that a taxpayer own or operate more than one business venture in order to be included on a combined return. The Department notes that the auditor worded the report in this manner in order to clarify and establish that the businesses had no Indiana operations and therefore no Indiana nexus. The wording was clearly not intended to place a multiple operation requirement on the taxpayer.

Next, taxpayer complains that it should be allowed to file a combined return including the two companies which do have Indiana nexus. Taxpayer states that to force it to file individually distorts Indiana income to the detriment of the two companies. The Department points out that taxpayer had the opportunity to submit an accurate petition to file a combined return. Instead, taxpayer opted to submit a petition that included nine out of eleven companies which, had the Department known all of the relevant facts at the time of the petition, would not be allowed on a combined return. IC 6-3-2-2(q) plainly states, "The petition to file a combined income return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year." Taxpayer did not complete and file a petition to file a combined return including the two companies with Indiana nexus within thirty days after the end of the taxpayer's taxable year, therefore taxpayer does not qualify under IC 6-3-2-2(q).

In conclusion, the Department properly determined that taxpayer did not qualify to file a combined return. Nine out of the eleven companies had no Indiana nexus at all. IC 6-3-2-2(*l*) and IC 6-3-2-2(q) provide the reasons and methods for petitioning to use alternative methods of calculating Indiana adjusted gross income tax. Taxpayer does not qualify for and did not properly petition to use such methods.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030474.LOF

LETTER OF FINDINGS NUMBER: 03-0474
Corporate Income Tax
Tax Period 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

1. Gross Income Tax-Imposition

Authority: IC 6-8.1-5-1(b); IC 6-2.1-2-2(a); 45 IAC 1.1-6-2; 45 IAC 1.1-1-3; 45 IAC 3.1-1-153(c)(1).

The taxpayer protests the imposition of Indiana gross income tax.

2. Adjusted Gross Income Tax- Imposition

Authority: IC 6-3-2-1(a); IC 6-3-2-2; IC 6-3-2-2.2.

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

STATEMENT OF FACTS

Taxpayer, a non-Indiana resident, was the general partner in two partnerships. Partnership "A" was engaged in retail and wholesale propane operations, both within and outside Indiana. Partnership "B" had no business activities, other than holding the corporation retailing propane. On March 26, 1999, the taxpayer sold its investment in the partnerships and became inactive. Two short period returns were filed for 1999.

Pursuant to an audit, the Indiana Department of Revenue, (department), assessed additional gross income tax, adjusted gross income tax interest and penalties for the tax period 1998-1999. The taxpayer protested the assessment concerning the imposition of Indiana gross income tax and Indiana adjusted gross income tax on the gain from the taxpayer's sale of its partnership interests for the 1999 tax year. The department held a hearing and now presents this Letter of Findings.

1. Gross Income Tax-Imposition

DISCUSSION

In 1999, the taxpayer sold its interests in the partnerships. The taxpayer failed to report these sales in its gross income calculation for the year 1999. On audit, the Department included the proceeds from the taxpayer's sale of the partnership interest in the taxpayer's gross income. The taxpayer protested this inclusion. The taxpayer argues the receipts from the sale of its intangible (the partnership interests) are not subject to the Indiana gross income tax. The taxpayer contends that since the gains were not derived from activities within Indiana, the department should not impose a tax on the proceeds from the sale.

Indiana Department of Revenue assessments are prima facie evidence that departments claim for unpaid taxes is valid**.** IC 6-8.1-5-1(b). The taxpayer has the burden of proving whether the department incorrectly imposed the assessment. Id.

IC 6-2.1-2-2 provides:

(a) An income tax, known as the gross income tax, is imposed upon the receipt of:

(1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and

(2) 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.

45 IAC 1.1-6-2 clarifies when an intangible is includible in gross income and provides:

(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 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....

45 IAC 1.1-1-3 defines "business situs" as:

(a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.

(b) A taxpayer may establish a business situs in ways, including, but not limited to the following:.…

(7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.

The department takes the view that, if a taxpayer has a commercial domicile outside of Indiana, the gains from the sale of its intangible are subject to the gross income tax when: (1) The taxpayer had a "business situs" in Indiana; and (2) The intangible sold formed an integral part of the taxpayer's business.

The taxpayer's sole business was managing and investing in the underlying operating partnerships. The taxpayer had a "business situs" in Indiana through its capacity as a general partner in the partnerships. Based on these facts, the taxpayer's proceeds from the sale of the partnership interests are subject to the gross income tax.

The proceeds from the sale of the taxpayer's partnership interest have been included in the taxable gross income per audit. Since the partnership conducted business both within and outside Indiana, the portions of the proceeds attributable to Indiana have been calculated by using the partnership's three factor formula. 45 IAC 3.1-1-153(c)(1).

The taxpayer insists the department erred in its assessment because the activities associated with the sale of the partnership interest all took place outside of Indiana. The sale was negotiated and carried out over a two-year period by the taxpayer's CEO in New York City.

The taxpayer errs in its argument. 45 IAC 1.1-6-2 (a), as cited above, states income resulting from activities in Indiana are subject to the Indiana gross income tax. In the taxpayer's case, a portion of the intangible (partnership interest) sold was directly related to the taxpayer's retail propane operations, which does business in Indiana. Thus, the assessment of the Indiana gross income tax is clearly related to the taxpayer's Indiana business.

FINDING

For the above reasons, the department denies the taxpayer's protest.

2. Adjusted Gross Income Tax- Imposition

DISCUSSION

The department assessed Indiana adjusted gross income tax on a portion of the gain from the taxpayer's sale of its partnership interest. The department maintains a portion of the gain, derived from the sale of the partnership interest, is business income attributable to Indiana. The taxpayer protested this assessment.

IC 6-3-2-1(a) imposes an adjusted gross income tax "on that part of the adjusted gross income derived from sources within Indiana of every nonresident person."

The taxpayer is domicile in Connecticut and is not a resident of Indiana. Therefore, the issue raised is whether the taxpayer's income from the sale of its partnership interest was from an Indiana source, that would subject the taxpayer to the Indiana adjusted gross income tax

IC 6-3-2-2 defines the term "adjusted gross income derived from sources within Indiana." IC 6-3-2-2(a)(5) provides:

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 6-3-2-2.2 explains when receipt of income from an intangible is attributable to Indiana. IC 6-3-2-2.2 provides:

(a) Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property are attributable to this state if the security or sale property is located in Indiana.

(b) Interest income and other receipts from consumer loans not secured by real or tangible personal property are attributable to this state if the loan is made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

(c) Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property are attributable to this state if the proceeds of the loan are to be applied in Indiana. If it cannot be determined where the funds are to be applied, the income and receipts are attributable to the state in which the business applied for the loan. As used in this section, "applied for," means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first.

(d) Interest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees are attributable to the state to which the card charges and fees are regularly billed.

(e) Receipts from the performance of fiduciary and other services are attributable to the state in which the benefits of the services are consumed. If the benefits are consumed in more than one (1) state, the receipts from those benefits are attributable to this state on a pro rata basis according to the portion of the benefits consumed in Indiana.

(f) Receipts from the issuance of traveler's checks, money orders, or United States savings bonds are attributable to the state in which the traveler's checks, money orders, or bonds are purchased.

(g) Receipts in the form of dividends from investments are attributable to this state if the taxpayer's commercial domicile is in Indiana.

There are no provisions within subsections (a) through (g) of IC 6-3-2-2.2 that would allow the sale of a partnership interest by a non domiciled corporation to be attributable to Indiana.

FINDING

The department sustains the taxpayer's protest.

DEPARTMENT OF STATE REVENUE

02-20040170.LOF
02-20040210.LOF
02-20040235.LOF

LETTER OF FINDINGS NUMBER: 04-0170, 04-0210, 04-0235
CORPORATE INCOME TAX
For Year 2000

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.

ISSUES

I. Gross Income Tax – Interstate commerce.

Authority: Ind. Code § 6-2.1-3-3; 45 IAC 1.1-3-3

Taxpayer protests the imposition of income tax on advertising fees collected from an Indiana limited partnership under the control of taxpayer.

STATEMENT OF FACTS

Taxpayer is a group of several companies, three involved in this protest, engaged in the manufacturing and sale of equipment. During the years in question, Taxpayer shipped its equipment to Indiana customers via common carrier. During the years in question, Taxpayer had an Indiana situs, with both property and payroll in Indiana.

Taxpayer reported that its income from its Indiana sales and service receipts was not subject to gross income tax. However, the Department found that Taxpayer had an Indiana business situs, and that its sales were directed from the Indiana business situs. Accordingly, Taxpayer was assessed additional tax and penalty, which Taxpayer has protested.

I. Gross Income Tax – Interstate Commerce

DISCUSSION

Taxpayer has asserted that, in general, its sales generally worked in a manner such as this: a customer would call Taxpayer, requesting to purchase its items. Taxpayer would then ship the items from its out-of-state location to its customer in Indiana or other states. Taxpayer maintains that the sales were made in interstate commerce, and therefore are exempt under Ind. Code § 6-2.1-3-3.

Under 45 IAC 1.1-3-3(d)(7),

[g]ross income derived from the sale of tangible personal property in interstate commerce is subject to the gross income tax if the sale is completed in Indiana. The following examples are situations where a sale is completed in Indiana prior to or after shipment in interstate commerce:

…

(7) A sale to an Indiana buyer by a nonresident seller if the sale:

(A) originated from;

(B) was channeled through; or

(C) was otherwise connected with;

an Indiana business situs established by the seller.

Thus, under the regulations, a two-part test must be met for taxation. First, a taxpayer must have a business situs in Indiana. Second, the sale in question must originate from, be channeled through or otherwise connected with that situs. That Taxpayer has a business situs in Indiana is not disputed. Taxpayer operates several divisions, some with an Indiana situs and others that Taxpayer maintains do not have Indiana situs. However, whenever a division of an entity is determined to have situs, the entire entity has situs, not just the individual division.

Taxpayer has, for all its subsidiaries, conceded that service receipts are taxable. That said, Taxpayer has provided sufficient documentation to conclude that the transaction through its divisions that it claimed did not have an Indiana situs (assuming such a thing can exist separately for divisions within an entity) did not meet the regulatory test, because Taxpayer established that the transactions did not originate from, were not channeled through, and were not otherwise connected with Taxpayer's Indiana business situs. However, to the extent that the sales were through divisions that had an Indiana situs, Taxpayer has not met its statutory burden of proof.

Further, one subsidiary also was a partner in a partnership that transacted business in Indiana. While Taxpayer has conceded that the sales equal to the partnership's Indiana sales times the partnership's apportionment percentage is taxable, Taxpayer has not provided sufficient information that its sales to Indiana are exempt, and accordingly Taxpayer is denied with respect to those receipts.

FINDING

The taxpayer is sustained in part and denied in part.

DEPARTMENT OF STATE REVENUE

04-20040408.LOF

LETTER OF FINDINGS: 04-0408
Sales and Use Tax
For Tax Period 2001-2003

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ISSUES

I. Sales and Use Tax—Leasing

Authority: Ind. Code § 6-2.5-4-10; Ind. Code § 6-8.1-5-1.

Taxpayer protests the imposition of use tax with respect to equipment leased by it from Taxpayer's owners.

II. Tax Administration: Negligence Penalty

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

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is a limited liability company that performs improvements to realty. In addition, Taxpayer's owners operate a farm with animals and crops. Taxpayer's owners lease inherited land, barns and excavating equipment to Taxpayer. The leases in question are the owners' only leases. As a result of an audit, Taxpayer was assessed use tax and penalty, which Taxpayer has protested.

DISCUSSION

I. Sales and Use Tax—Leasing

In general, the lease or rental of tangible personal property is subject to sales tax. Ind. Code § 6-2.5-4-10(a), which stated during the relevant period "[a] person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person."

Here, Taxpayer has presented an argument related to *self-employment taxes*. It noted that real estate was also being leased to Taxpayer, which would not subject the combined lease to self-employment taxes according to Taxpayer. This does not go to the question at hand: whether Taxpayer leased tangible personal property from its owners. While the rental of real estate may or may not be subject to sales or use tax, neither Taxpayer nor its owners separated the amounts for leases of real property or personal property. Taxpayer has also sought the benefit of depreciation deductions for the property in question, lending more credence to the notion that Taxpayer and its owners sought the benefits of their transaction as a business transaction. Further, the leases in question totaled over $130,000 for the years in question—not exactly an isolated transaction. Accordingly, the auditor's determination that the rentals represented tangible personal property has not been rebutted—its burden per Ind. Code § 6-8.1-5-1, and thus Taxpayer's protest is denied

FINDING

Taxpayer's protest is denied.

II. Tax Administration: Negligence Penalty

The Department may impose a ten percent (10%) negligence penalty. Ind. Code § 6-8.1-10-2.1 and 45 IAC 15-11-2. Taxpayer's failure to timely file income tax returns, generally, will result in penalty assessment. Ind. Code § 6-8.1-10-2.1(a)(1). The Department, however, may waive this penalty if the taxpayer can establish that its failure to file "was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). A taxpayer may demonstrate reasonable cause by showing "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*. Taxpayer has not made the necessary showing in this case.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420050143.LOF

LETTER OF FINDINGS NUMBER: 05-0143
Sales and Use Tax
For Tax Years 2005

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ISSUE

I. Sales and Use—Aircraft Purchase

Authority: 45 IAC 2.2-5-15

Taxpayer protests the denial of a claim for exemption.

STATEMENT OF FACTS

Taxpayer purchased an aircraft but did not pay sales tax on the purchase, claiming an exemption for rental or lease to others. Taxpayer also claimed a trade-in allowance on the purchase of the aircraft. The Indiana Department of Revenue ("Department") reviewed the claim for exemption and the claim for trade-in allowance and determined that taxpayer did not qualify for the exemption. The Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the imposition of proposed assessments. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer protests the imposition of sales tax on its purchase of an aircraft. Taxpayer is a partnership which signed a lease agreement with another partnership. The partners of both partnerships are identical. Taxpayer purchased the aircraft in 2005 for five hundred, forty thousand dollars ($540,000.00) with a trade-in allowance of twenty-five thousand dollars ($25,000.00) for a final purchase price of five hundred, fifteen thousand dollars ($515,000.00). The Department denied taxpayer's claim for a rental exemption and disallowed the trade-in value on the purchase of the subject aircraft.

Taxpayer protests that it qualifies for the rental exemption found in 45 IAC 2.2-5-15, which states:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it was sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

Taxpayer states that it was always its intention to acquire and lease the aircraft to the other partnership and that the purchase of aircraft should be exempt. Taxpayer states that sales tax, if any, would be on the lease stream and not on the purchase price.

Taxpayer has not provided any documentation to establish that there is, in fact, a lease stream. Taxpayer has not provided any documentation to establish that it received any payments from its "lessee". Taxpayer has not provided any documentation to establish that it is in the business of leasing an aircraft. 45 IAC 2.2-5-15 clearly states that to qualify for the exemption, a taxpayer must be occupationally engaged in the business of reselling, renting or leasing such property in the regular course of its business. Taxpayer is not occupationally engaged in the reselling, renting or leasing of the subject aircraft and does not qualify for the claimed exemption.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420050363.LOF

LETTER OF FINDINGS NUMBER: 05-0363
Sales and Use Tax for 2004

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/Use Tax—Assessment on Purchase of Aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5; IC 6-2.5-3-4; IC 6-2.5-5-8(b); IC 6-6-6.5-2; IC 6-2.5-4-10(a); IC 6-2.5-2-1; Form 7695; Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner, 968 F.2d 1229 (D.C, Cir. 1992); Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 55 N.E. 745 (1899); *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the assessment of sales and use tax on the purchase of an aircraft Taxpayer asserts is rented and leased.

STATEMENT OF FACTS

Taxpayer is a limited liability company. It purchased an aircraft in July 2004 which it leases to affiliated entity, BM. Taxpayer filed its application for aircraft registration and claimed a sales and use tax exemption for rental or lease to others per IC 6-2.5-5-8. The Department denied the exemption, finding there was insufficient evidence to support the claim of rental or leasing. Sales and use tax were assessed. A protest was filed and a hearing was held.

I. Sales/Use Tax—Assessment on Purchase of Aircraft

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).

In July 2004, Taxpayer purchased an aircraft and in August 2004 moved the aircraft to Indiana. IC 6-2.5-3-2 imposes an excise tax, commonly known as the use tax, on the storage, use, or consumption of an aircraft if the aircraft (1) is acquired in a transaction that is an isolated or occasional sale; and (2) is required to be titled, licensed, or registered by this state for use in Indiana. In the case of aircraft, taxpayers are to pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

Exemptions to the imposition of sales and use tax exist. *See* IC 6-2.5-5 and IC 6-2.5-3-4. IC 6-2.5-5-8(b) exempts from sales tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

> It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-6-6.5-2 requires an Indiana resident to register his aircraft with the state through the Department within 31 days of the purchase date. Taxpayer filed a Form 7695 and claimed in Section D, a sale and use tax exemption for "Rental or Lease to others."

IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by Taxpayer to others. This means that sales tax is to be imposed on and collected from BM when it uses Taxpayer's aircraft.

Taxpayer claims it is entitled to a sales and use tax exemption because it is engaged in the rental of the aircraft to others. This requires an analysis of the substance and form of the agreements Taxpayer has entered into with the BM. This requires a discussion of FAA regulations.

Aircraft operated in the United States are subject to strict regulation by the United States Department of Transportation, Federal Aviation Administration. Among its responsibilities and duties, the FAA regulates the registration, airworthiness certification, and continued operational safety of aircraft. Title 14, Chapter I of the Code of Federal Regulations contain the FAA's regulations (FAR). The regulations are organized by Parts and Subparts. Part 91 contains the general operating and flight rules. In general—with few exceptions not relevant to this protest before the Department—Part 91 applies to the operation of all aircraft and regulates all persons on board an aircraft. *See* FAR § 91.1. FAR § 91.315 and FAR § 91.325 do not permit a person to operate an aircraft for compensation or hire to carry others or to carry property. Operations for compensation and hire are regulated by Parts 121 and 135. Part 121 regulates operations of a commercial airliner and Part 135 regulates operations of a charter or air-taxi service. Those whose business is the transportation for compensation and hire under Part 121 and Part 135 are held to higher, stricter operating standards. Taxpayer has acknowledged these facts and has noted that the acquisition of a Part 121 or Part 135 certification is time-consuming and expensive.

Those operating solely under Part 91 authority operate in personal transportation of themselves only. Guests and other passengers are to be transported for no charge. FAR § 91.501 does name the narrow exceptions permitted to recover specific expenses for demonstrations to prospective customers, the carriage of property within the scope of business or employment, and in time-share agreements. But in general, those operating under Part 91 are required to operate in personal transportation only. Under Part 91, the FAA highly restricts the carriage of property and others for hire and compensation. It does permit the leasing of an aircraft to others, but to do so and remain within the requirements of Part 91, the operational control of the aircraft has to be transferred from the owner of the aircraft to the user of the aircraft. This type of lease is termed a dry lease. Operational control is defined in FAR § 1.1 as the exercise of authority over initiating, conducting or terminating a flight.

In a dry lease, the owner of the aircraft only charges for the physical use of the aircraft—with no charges for incidental costs. The lessee is required and responsible to provide and pay the costs for pilots, operational supplies, and maintenance under the requirements of Part 91. When a dry lease is used, the FAA does not consider the use of the aircraft to be a transportation service.

Analysis of the form and function

BM has a need for an aircraft to transport members and employees. Because Taxpayer and BM are related, many of the members and employees of Taxpayer and the affiliated entity are the same persons. If BM had purchased an aircraft or a fractional share in an aircraft, sales or use tax would have been due because no applicable tax exemption could be leveraged. But if the aircraft is purchased by an affiliated company and it holds the asset, those who seek to benefit their primary business enterprises can purchase the aircraft in an attempt to avoid paying sales tax by claiming to "rent" the aircraft to themselves. The 6% sales tax on $322,500 is $19,350. That is a substantial amount to seek to avoid paying. But in order to comply with FAA Part 91 requirements, Taxpayer cannot operate the aircraft on behalf of BM. Under FAA regulations, control of the aircraft has to be placed with BM. Taxpayer claims that the placement of the aircraft into a separate entity serves to insulate it from liability. But Taxpayer doesn't operate the aircraft—it merely holds the asset for the benefit of BM. The Department asked Taxpayer to produce copies of the insurance policies held by the related company, BM. Taxpayer did not produce copies of those insurance policies and stated that only Taxpayer maintains insurance coverage on the aircraft to protect its asset. However, the policy states:

> Item 6. AIRCRAFT USE. The policy shall not apply to any **Insured** while the **aircraft** is being used with the knowledge and consent of such Insured for any purpose involving a charge intended to result in financial profit to such **Insured** unless otherwise indicated herein. [bold original]

These statements indicate that the insurance covers the use of the aircraft by Taxpayer and no other use. This contradicts the leasing arrangement that Taxpayer has with the affiliated company. Taxpayer obtained insurance at a favorable rate based on the use it stated to the insurance company. But Taxpayer does not and cannot operate the aircraft because the sole purpose for the creation of Taxpayer as a business entity is to hold the aircraft as an asset. If it operates the aircraft—it becomes a transportation company and is held to the higher FAA regulations of Part 135. Part 91 requires that a lessee in a dry lease provide and pay for operation expenses, such as pilot services, maintenance, fuel, and insurance. FAR § 91.403 states that those with operational control are responsible for maintaining an aircraft in an airworthy condition.

Taxpayer stated in its brief submitted to Department that the reason that the aircraft is held in a separate entity is for liability reasons.

> The use of a subsidiary company provides some asset protection. Because there is only a handful of insurance companies in the aircraft insurance business, there is no adequate source of liability insurance for Part 91 operators.
>
> …
>
> In the case of Part 91 operators, the aircraft is held in a separate corporation primarily for liability reasons. As a general rule, Part 91 operators can obtain no more than $100,000 per seat in liability coverage which is far below any actual potential damages resulting in injury or death to a passenger.

Taxpayer and the affiliated company, BM, seek to limit liability and protect assets, but BM has not secured insurance for its operation of the aircraft. Since under Part 91, operational control has to be transferred to the lessee, it is the lessee—in this case BM—that bears liability when operating the aircraft. BM has not provided evidence that it has purchased insurance coverage on the aircraft. Taxpayer has stated that the only insurance policy on the aircraft is the one held and paid for by Taxpayer. The leases between Taxpayer and BM requires that the related company to maintain liability insurance covering public liability and property damage of no less than $1 million. The lease outlines other insurance requirements. The lack of insurance coverage by BM is an indication that the relationship between Taxpayer and the affiliated companies can be collapsed.

Application of the Sham Transaction Doctrine

The lease agreements and the effect of the operation of the aircraft fall squarely within the doctrine of sham transaction. The sham transaction doctrine is well establish in state and federal tax jurisprudence. In Gregory v. Helvering, 293 U.S. 465, 469 (1935), the United States Supreme 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. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. *Id.* at 470. Transactions invalidated by the sham transaction doctrine are those motivated by nothing more than the taxpayer's desire to secure the attached tax benefit but are devoid of any economic substance.

See Horn v. Commissioner, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992).

If the affiliated companies were required to purchase transportation services in accordance with FAA regulations, they would need to secure a third-party to provide them with air travel services—operated under Part 121, an airline, or Part 135, an air-taxi/charter service. What the affiliated companies would pay to the third-party would be applied to the costs of third-party to have purchased an aircraft and to operate that aircraft. But the affiliated companies do not wish to pay those costs—and they need not. What the affiliated companies want is an aircraft of their own that they can control. And that is what they have acquired. The acquisition of the aircraft triggered sales and use tax. Taxpayer and the affiliated companies structured the transaction to secure the benefits of an exemption—but did not assume the associated burdens. The Indiana Supreme Court—as well as courts across the land—have stated that a party cannot have the benefits without the burdens. *See* Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 301-02; 55 N.E. 745, 749 (1899).

Taxpayer has secured the tax benefit of avoiding sales and use tax on the purchase of the aircraft. Additionally, because of the requirements of FAA regulations, Taxpayer cannot operate the aircraft on behalf of BM; Taxpayer has to give the aircraft and operational control to the related company and it is required to maintain the aircraft and pay the necessary associated expenses. The rental rate is set to cover the cost of using the aircraft asset—and that is all that can be charged and still comply with FAA regulations. The hourly rental rate is $120. Taxpayer acknowledges the fair market value comparison rate is around $280 per hour. Taxpayer states that the rental rate paid by the affiliated companies is reduced because it is responsible for maintaining the aircraft. The net effect of all this is that BM gets what it wanted all along—control and use of an aircraft; but it has avoided the upfront, one-time cost of having to pay the sales and use tax due. If BM had purchased the aircraft outright, it still would be responsible for the associated costs of operating and maintaining the aircraft. But by structuring the transaction as it has, while it still has to pay those associated costs, the lease payments made to Taxpayer remain in the coffers of those who have ownership interests—the members. The lease payment is a wash. As well, the lease payments due to Taxpayer are reduced to reflect the assumption of the associated costs by BM. The net effect is that negligible sales tax is imposed, collected, and remitted on what is a transaction without economic substance. The business of America is business—and no business is generated here.

The relationship between Taxpayer and BM is interfamilial. There is not rental and leasing to others; it is renting and leasing to self. On the lease, the member who signs for Taxpayer is the same person who signs as member for BM. There is no arms-length transaction to others; these are one and the same persons benefiting. IC 6-2.5-5-8(b) grants a sales tax exemption if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business. *Black's Law Dictionary*, Seventh Edition, defines business as "a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain." Taxpayer does not have a profit motive; Taxpayer has stated that the purpose of establishing the separate entity to hold the aircraft is for liability benefits. The sales and use tax exemption for resale, rental, or leasing in the ordinary course of the person's business is not granted for those seeking to secure liability benefits; it is granted to those with a profit motive who will generate revenues from rental and lease transactions upon which sales tax is imposed. Taxpayer is not engaged in rental or leasing for the purposes of the sales and use tax statutes.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420050396.LOF

LETTER OF FINDINGS NUMBER: 05-0396
Sales and Use Tax
For the Years 2000-2004

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.

ISSUES

I. Sales and Use Tax- Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-3-2(a), IC 26-1-2-401(2),

The taxpayer protests the imposition of sales tax.

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

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b), 45 IAC 15-11-2(c), IC 6-8.1-10-1(a).

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

STATEMENT OF FACTS

The taxpayer is an Illinois corporation that makes sales to Indiana customers. 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 paid a portion of the assessment and protested the remainder. At the taxpayer's request, this Letter of Findings is based upon the documentation in the file.

I. Sales and Use Tax-Imposition

The taxpayer operated as a retail merchant selling office equipment, office supplies and office furniture from their store in Illinois. The taxpayer used its own delivery vehicles to deliver merchandise to Indiana customers. The taxpayer was not registered to collect Indiana sales tax for the period under review. It did not collect or remit any sales or use tax to Indiana. The taxpayer has now applied for a Registered Retail Merchants Certificate.

The department assessed sales tax on the sales of merchandise that was delivered by the taxpayer to Indiana customers. The taxpayer protests some of these assessments.

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. Indiana also imposes a complementary excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana if sales tax was not paid at the time of purchase. IC 6-2.5-3-2 (a).

The Indiana law concerning the passing of title of goods to the buyer states that, "Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods... IC 26-1-2-401(2). Title to the merchandise that the taxpayer delivered in its own delivery trucks to Indiana customers was passed in Indiana. Therefore these sales were Indiana sales which the taxpayer had to collect and remit sales tax unless there was an exemption.

The taxpayer first protested that Indiana sales tax was incorrectly assessed on an invoice dated October 27 2004 in the amount of $4,494. This invoice is found in Taxpayer's Attachment 12. This invoice represents the sale of certain office equipment to an Illinois purchaser and that Illinois sales tax was collected. The Illinois purchaser later leased the office equipment to an Indiana company. In that case, the sale took place in Indiana and the taxpayer correctly collected and remitted the Illinois sales tax to Illinois. The taxpayer's request to have this amount deducted from the audit assessment is sustained. This adjustment amounts to an amount of $224.70 to be deducted from the audit assessment.

The taxpayer also protests the sales tax assessed on an invoice dated December 18, 2000 representing a sale of equipment to an exempt user in Indiana. The taxpayer provided at Attachment 11 a copy of the customer's Indiana Tax Exemption Certificate. The taxpayer's protest to the assessment of $143.50 is sustained.

The taxpayer also protested the assessment of sales tax on sales to several purchasers where the tax has already been paid. Therefore, the taxpayer is not now liable for sales tax on these sales. The sales tax associated with these sales is $2,555.25. This point of the taxpayer's protest is sustained.

The taxpayer also protests the placement of an exempt sale in December, 2001 rather than in January, 2002. The invoice (found at Attachment 13) was dated December 31, 2001. The taxpayer provided adequate substantiation that the amount of the invoice should have been included in the January 2002 exempt sales. This point of protest is sustained and results in a $24.10 deduction from the tax assessment.

FINDING

The taxpayer's protests are sustained.

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

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 department has the authority to waive the negligence penalty pursuant to the provisions of 45 IAC 15-11-2(c) as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to

reasonable cause and not due to negligence...

In this case, the taxpayer submitted substantial documentation to indicate that its failure to collect and remit Indiana sales tax was due to reasonable cause.

The taxpayer also contends that the department should abate the interest imposed in this matter.

The department imposes interest pursuant to IC 6-8.1-10-1(a). The department is specifically denied the ability to waive interest at IC 6-8.1-10-1(e). Therefore, the department cannot waive the interest assessed against the taxpayer in this instance. The taxpayer's protest to the imposition of interest is denied.

FINDING

The taxpayer's protest to the imposition of the penalty is sustained. The taxpayer's protest to the imposition of interest is denied.

DEPARTMENT OF STATE REVENUE

02-20050399.LOF

LETTER OF FINDINGS NUMBER: 05-0399
CORPORATE INCOME TAX
For Years 2001-2002

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.

ISSUES

I. Gross Income Tax – Applicability

Authority: Ind. Code § 6-2.1-2-2

Taxpayer protests the imposition of gross income tax on management fees paid to employees who did work both inside and outside Indiana.

II. Adjusted Gross Income Tax – Consolidated filing

Authority: Ind. Code § 6-3-2-2; Ind. Code § 6-3-4-14

Taxpayer protests the use of a "stacked" method for computing the adjusted gross income tax liability for its consolidated group.

STATEMENT OF FACTS

Taxpayer is a group of several companies, five of which are at issue in this protest. During 2001, Taxpayer had three management employees who did various work for the company both inside and outside Indiana. However, Taxpayer did not report gross receipts with respect to management fees paid. The Department assessed gross income tax with respect to the management fees, based on the fraction of Taxpayer's Indiana payroll to Taxpayer's overall payroll.

For 2002, Taxpayer filed a consolidated return with five companies included. Four of the companies had significant combined income and significant Indiana apportionment factors; however, a fifth company had significant losses greater than the income of the other four entities combined, and had separately computed apportionment factors relatively lower than the other four companies. As a result of audit, four companies had their combined tax computed under a normal apportionment formula, while the fifth company had its income computed separately.

I. Gross Income Tax – Applicability

DISCUSSION

Taxpayer protests the applicability of gross income tax to management fees that the Department deemed to be Indiana source income. Ind. Code § 6-2.1-2-2 (repealed effective January 1, 2003) provided that gross income tax is imposed on the receipt of "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." Here, Taxpayer argues that it is not necessarily possible to determine whether services (or a portion of the services) was performed in Indiana or another state. Taxpayer has not provided sufficient information to rebut the assessment, and accordingly is denied.

FINDING

The taxpayer is denied.

II. Adjusted Gross Income Tax – Consolidated filing

DISCUSSION

Taxpayer protests the method used to determine its adjusted gross income tax liability. Taxpayer notes that, in general, an affiliated group of corporations that have income from Indiana sources are eligible to file a consolidated return under Ind. Code § 6-3-4-14. In a consolidated return, the affiliated group is generally treated as one large corporation. This is in contrast to taxing the affiliated corporations effectively as separate companies and adding their tax liabilities together, generally called the "stacked" method. While Ind. Code § 6-3-2-2(l) and (m) provide for remedial provisions in instances in which income may not be fairly reflected by normal allocation and apportionment methods, Taxpayer has provided sufficient evidence that the remedial provisions provided in those sections are not applicable to its fact situation. Accordingly, Taxpayer's protest is sustained.

FINDING

The taxpayer is sustained.

DEPARTMENT OF STATE REVENUE

04-20050443.LOF

LETTER OF FINDINGS NUMBER: 05-0443
Sales and Withholding Tax
Responsible Officer
For the Year 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. Sales and Withholding Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3; IC 6-3-4-8, IC 6-8.1-5-1; Indiana Department of Revenue v. Safayan, 654 N.E.2d 270 (Ind. 1995).

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

STATEMENT OF FACTS

Taxpayer was a shareholder and officer for a corporation. Taxpayer passed away in 1997. However, the corporation failed to remit sales and withholding tax for 2000, and the taxpayer was assessed as a responsible officer of the corporation for failure to remit those taxes.

I. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

The proposed sales tax and withholding tax liability was issued under authority of Ind. Code § 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 (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. If the individual knowingly fails to collect or remit those taxes to the state, he commits a Class D felony.

The proposed withholding taxes were assessed against taxpayer pursuant to Ind. Code § 6-3-4-8. Also of import is Indiana Department of Revenue v. Safayan, 654 N.E.2nd 270, 273 (Ind.1995), which states "The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that they are paid."

Finally, the Indiana Department of Revenue's "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid." Ind. Code § 6-8.1-5-1(b). That statute also states the burden of proof rests with the taxpayer.

Taxpayer was deceased at the time of the failure to remit. Accordingly, Taxpayer was not an officer or employer of the corporation at the time of the failure to remit.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2005-14ST
December 9, 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 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

Use Tax—Leasing of an Aircraft to an Affiliated Entity

Authority: IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5; IC 6-2.5-3-4; IC 6-2.5-5-8(b); IC 6-2.5-3-5; IC 6-6-6.5-2; IC 6-2.5-4-10(a); IC 6-2.5-2-1; Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); FAR § 91.1; FAR § 91.315; FAR § 91.325; FAR § 91.501; FAR § 1.1.

STATEMENT OF FACTS

The taxpayer is an limited liability company that was formed for the business purpose of owning and leasing aircraft. The taxpayer owns an aircraft and leases it to an affiliated entity. The taxpayer states that the aircraft is leased under a five year dry lease which is absolute and unconditional to the affiliated entity. The taxpayer also states that it has valued the aircraft and has determined a rate of return on the aircraft investment. Taxpayer states that based on the analysis, it was determined the projected internal rate of return exceeds the taxpayer's cost of capital and will provide the taxpayer a profitable return on the investment. The aircraft has been hangared in another state from the lease inception until now. The taxpayer has collected and remitted sales tax on the monthly lease payments as required by that state's law.

The taxpayer describes the business purposes of the affiliated entity; the affiliated entity is in a business unrelated to aircraft. The business objectives of the affiliated entity are to maximize shareholder value through its management and development of [building enterprises]. The taxpayer states that it makes business sense for the affiliated entity to lease aircraft to ease the travel burden for senior level executives that manage 90 [building enterprises] throughout the United States; it does not make sense for the affiliated company to own aircraft or distort its financial statements with financial results related to the ownership of aircraft. The taxpayer was formed for the purpose of owning and leasing aircraft.

The taxpayer requests a ruling on the tax consequences of basing and hangaring the aircraft in Indiana.

DISCUSSION

IC 6-2.5-3-2 imposes an excise tax, commonly known as the use tax, on the storage, use, or consumption of an aircraft if the aircraft (1) is acquired in a transaction that is an isolated or occasional sale; and (2) is required to be titled, licensed, or registered by this state for use in Indiana. In the case of aircraft, taxpayers are to pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

Exemptions to the imposition of sales and use tax exist. *See* IC 6-2.5-5 and IC 6-2.5-3-4. IC 6-2.5-5-8(b) exempts from sales tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

> It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-2.5-3-5, Credit for payment of other taxes, states: A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property.

IC 6-6-6.5-2 requires an Indiana resident to register his aircraft with the state through the Department within 31 days of the purchase date or for a non-resident who bases an aircraft in this state for more than 60 days to register the aircraft with the Department within 60 days after establishing a base in Indiana.

IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by the taxpayer to the affiliated company. The taxpayer and affiliated company do not dispute this.

However, the taxpayer claims it is entitled to a use tax exemption on the acquisition of the aircraft because it is engaged in the rental of the aircraft to others. This requires an analysis of the substance and form of the agreements the taxpayer has entered into with the affiliated entity. This requires a discussion of FAA regulations.

Aircraft operated in the United States are subject to strict regulation by the United States Department of Transportation, Federal Aviation Administration. Among its responsibilities and duties, the FAA regulates the registration, airworthiness certification, and continued operational safety of aircraft. Title 14, Chapter I of the Code of Federal Regulations contain the FAA's regulations (FAR). The regulations are organized by Parts and Subparts. Part 91 contains the general operating and flight rules. In general—with few exceptions not relevant to this ruling—Part 91 applies to the operation of all aircraft and regulates all persons on board an aircraft. *See* FAR § 91.1. FAR § 91.315 and FAR § 91.325 do not permit a person to operate an aircraft for compensation or hire to carry others or to carry property. Operations for compensation and hire are regulated by Parts 121 and 135. Part 121 regulates operations of a commercial airliner and Part 135 regulates operations of a charter or air-taxi service. Those whose business is the transportation for compensation and hire under Part 121 and Part 135 are held to higher, stricter operating standards. The taxpayer does not state in its ruling request under which Part the aircraft is operated, but based on the information provided, which is that an exclusive five year dry lease has been executed with the affiliated entity, it is reasonable to presume that the aircraft is operated under Part 91 and not Part 121 or 135.

Those operating solely under Part 91 authority operate in personal transportation of themselves only. Guests and other passengers are to be transported for no charge. FAR § 91.501 does name the narrow exceptions permitted to recover specific expenses for demonstrations to prospective customers, the carriage of property within the scope of business or employment, and in time-share agreements. But in general, those operating under Part 91 are required to operate in personal transportation only. Under Part 91, the FAA highly restricts the carriage of property and others for hire and compensation. It does permit the leasing of an aircraft to others, but to do so and remain within the requirements of Part 91, the operational control of the aircraft has to be transferred from the owner of the aircraft to the user of the aircraft. This type of lease is termed a dry lease. Operational control is defined in FAR § 1.1 as the exercise of authority over initiating, conducting or terminating a flight.

In a dry lease, the owner of the aircraft only charges for the physical use of the aircraft—with no charges for incidental costs. The lessee is required and responsible to provide and pay the costs for pilots, operational supplies, and maintenance under the requirements of Part 91. When a dry lease is used, the FAA does not consider the use of the aircraft to be a transportation service. The taxpayer has indicated that it does not operate a transportation service, but instead is in the business of owning an aircraft for dry leasing.

Analysis of the form and function of the lease agreement and arrangement

The affiliated entity has a need for an aircraft to transport its employees. Because the taxpayer and the affiliated company are related, some of the employees and officers are the same persons. For example, the Chief Financial Officer who signed the lease agreement for the taxpayer is also the Chief Financial Officer who signed the lease for the affiliated entity.

If the affiliated entity had purchased an aircraft, sales or use tax would have been due because no applicable tax exemption could be leveraged. But if the aircraft is purchased by an affiliated company and it holds the asset, those who seek to benefit their primary business enterprises can purchase the aircraft in an attempt to avoid paying sales or use tax in a lump sum by claiming to "rent" the aircraft to themselves and then paying sales tax over time when it is collected on the lease payments. The taxpayer's aircraft was purchased at over $9 million. The avoidance of the lump sum sales and use tax on that amount is understandable. But in order to comply with FAA Part 91 requirements, the taxpayer cannot operate the aircraft on behalf of the affiliated entity. Under FAA regulations, control of the aircraft has to be placed with the affiliated entity. The taxpayer claims that the placement of the aircraft into a separate entity serves to not distort the financial statements of the affiliated company with the ownership of an aircraft. But the taxpayer doesn't operate the aircraft—it merely holds the asset for the benefit of the affiliated company. When the transaction is collapsed, the affiliated entity still has control and use of a capital asset. The Department acknowledges that placement of the aircraft into a separate but related company makes sound business sense so as to not distort the financial records. But under the FAA regulations, in order for the aircraft to be operated under Part 91, all control and costs of operating the aircraft must be placed into the hands of the lessee, in this case, the affiliated entity. These operational costs are part of the affiliated company's running of its business. The exclusive control of the aircraft is also a cost of the affiliated company doing business.

The net effect of all this is that the affiliated company gets control and use of an aircraft; but it has avoided the upfront, one-time cost of having to pay the sales or use tax due. If the affiliated company had purchased the aircraft outright, it still would be responsible for the associated costs of operating and maintaining the aircraft. But by structuring the transaction as it has, the affiliated company still gets the benefit of an aircraft and the lease payments made to the taxpayer are a wash in the overall combined financial picture of the taxpayer and the affiliated company because the two companies are related—thus the lease payments are inter-company transfers.

The taxpayer acknowledges that it is related to the affiliated entity. There is not rental and leasing to others; it is renting and leasing to self. IC 6-2.5-5-8(b) grants a sales and use tax exemption if the person acquiring the property acquires it for resale, rental, or leasing [to others] in the ordinary course of the person's business. The taxpayer is not engaged in rental or leasing to others for the purposes of the use tax statutes.

RULING

The Department rules that the taxpayer will be liable for use tax if it bases the aircraft in Indiana.

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.

Water Pollution Control Board

A non-rule policy document is a policy or statement that interprets, supplements or implements a statute or rule. It is not intended by the department to have the effect of law and is not related solely to internal department organization. Per Indiana Code 13-14-1-11.5, a non-rule policy document may not be put into effect until 30 days after the policy or statement is made available for public inspection and comments and presented to the Water Pollution Control Board.

ID#	POLICY TITLE	POLICY DESCRIPTION	ADOPTED	LAST REVISED	CITATION	CONTACT(S)
Water-001-NRD	Constructed Wetland Wastewater Treatment Facilities Guidance	Policy and technical guidance for the design, construction and operation of constructed wetland type sanitary wastewater treatment facilities	May 1, 1997	N/A	327 IAC 2,3,5,8 410 IAC 6-10	Jay Hanko (317) 233-3555
Water-002-NRD	Antidegradation Requirements for Outstanding State Resource Waters Inside the Great Lakes Basin	Provides a definition of significant lowering of water quality applicable to Outstanding State Resource Waters Inside the Great Lakes Basin	March 23, 1998	N/A	327 IAC 5-2-11.7(a)(2)(B)	Lonnie Brumfield (317) 233-2547 Dennis Clark (317) 308-3235
Water-003-NRD	Combined Sewer Overflow (CSO) Long-Term Control Plan Use Attainability Analysis Guidance	This document fulfills the mandates of P.L.140-2000 (SEA 431, passed in 2000) by providing guidance to municipal National Pollutant Discharge Elimination System (NPDES) permittees with combined sewer collection systems.	December 14, 2001	N/A	327 IAC 2,5	Bruno Pigott (317) 232-8631
Water–005-NRD	Review of Sanitary Sewer Construction Permit Applications For Communities with Combined Sewer Overflow Outfalls	This document outlines IDEM's procedures for review of sewer construction permit applications for communities with combined sewer overflow outfalls	April 9, 2003	N/A	327 IAC 3-1-1 through 327 IAC 3-6-32	Ken Lee (317) 232-8660
Water-006-NRD	Environmental Notice for Mitigation required in Clean Water Act Section 401 State Water Quality Certifications	To consistently implement the CWA §401 State Water Quality Certification program and the State Regulated Wetland Permitting program, IDEM will not require a deed restriction as a condition for a CWA §401 State Water Quality Certification.	September 14, 2005	N/A	IC 13-18-22; 327 IAC 17	Martha Clark Mettler (317) 232-8402

Water-007-NRD	Compliance and Technical Assistance Program Quality Assurance Guarantee	To provide a quality assurance guarantee to an individual, municipality, business or other entity that has received confidential compliance assistance from the CTAP of the Office of Pollution Prevention and Technical Assistance and upon which such regulated entity may have relied to its detriment.	January 11, 2006 (If an NPD is presented to more than one board, it will be effective 30 days after presentation to the last. This NPD will not become effective until February 19, 2006.)	N/A	IC 13-28; IC 13-30-6	Paula Smith (317) 233-5624

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