

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 23249
[Redacted],	)	
	)	
Petitioner.	)	DECISION
_____	)	

On June 21, 2010, the staff of the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (taxpayer) proposing use tax and interest for the period May 1, 2003, through December 31, 2009, in the total amount of \$721,024.

On August 17, 2010, the taxpayer filed a timely appeal and petition for redetermination. The Commission held an informal hearing with the taxpayer on January 4, 2010. For the reasons that follow, the Commission upholds the audit findings but modifies the liability.

At issue in this case is the imposition of use tax on the purchase of [Redacted]. Two of them are [Redacted]. The taxpayer claims that the use of the [Redacted] is exempt from tax because they were used primarily to [Redacted]. The auditor examined the use of the [Redacted] over the audit period and concluded that none of the [Redacted] qualified for the exemption.

**Relevant Idaho Tax Codes and Administrative Rules**

In Idaho, the sale of tangible personal property is taxable unless an exemption applies (Idaho Code §§ 63-3612 and 63-3619). Idaho also imposes a use tax on the storage, use, or other consumption of tangible personal property in Idaho. Payment of sales tax to a vendor extinguishes the use tax liability. Therefore, purchases subject to use tax are only taxable when the purchaser buys goods without paying tax to the seller at the time of sale. The use tax rate is

the same as the sales tax rate, and a recent sales price is presumptive evidence of the value subject to tax (Idaho Code § 63-3621(a)).

The taxpayer bought all three aircraft consecutively from one Idaho-registered [Redacted]. Each time, according to the taxpayer, it claimed the exemption noted above, providing passenger or freight services for hire. In its prior form, which was effective until the final six months of the audit period, the relevant part of that exemption statute reads as follows:

Aircraft. There is exempted from the taxes imposed by this chapter:

(1) The sale, lease, purchase, or use of aircraft primarily used to transport passengers or freight for hire... (Idaho Code § 63-3622GG, effective to June 30, 2009).

Sales and Use Tax Administrative Rule 037, in relevant part, follows:

01. Definitions. For the purposes of this rule, the following terms have the following meanings: (7-1-94)

...b. Freight. Goods transported by a carrier between two (2) points. Freight does not include goods which are being transported for the purpose of aerial spraying or dumping. See Subsection 037.05 of this rule. (4-11-06)

...c. Transportation of Passengers. The transportation of passengers means the service of transporting passengers from one (1) point to another. It does not include survey flights, recreational or sightseeing flights, nor does it include any flight that begins and ends at the same point. (4-11-06)

...g. Transportation of freight or passengers for hire. "Transportation of freight or passengers for hire" means the business of transporting persons or property for compensation from one (1) location on the ground or water to another. Such transportation must be offered indiscriminately to the general public. Entities such as LLCs or closely held corporations, that only transport related parties, including but not limited to employees or family members of the owner of the aircraft are not in the business of transporting freight or passengers for hire. (3-4-10)

02. Sales of Aircraft. Sales of aircraft are taxable unless an exemption applies. Section 63-3622GG, Idaho Code, provides an exemption for the sale, lease, purchase, or use of an aircraft: (4-11-06)

...a. Primarily used to transport passengers or freight for hire; (2-18-02)

03. Federal Law Prohibits States From Taxing Sales of Air Transportation. See 49 U.S.C. Section 40116. For this reason, sales of intrastate transportation as described by Section 63-3612(i), Idaho Code, are not taxable in Idaho. (4-11-06) (IDAPA 35.01.02.037. Dates in parentheses indicate adoption by the Idaho legislature).

### Background

In 2001, the taxpayer purchased a [Redacted] which it held until trading it in for another [Redacted] on October 20, 2004. This second [Redacted] was traded-in for a [Redacted] on December 19, 2007. This third aircraft was owned by the taxpayer at least through the end of the audit period, December 31, 2009.

Upon acquisition of each aircraft, [Redacted], under contracts that called for the manager to make them available for [Redacted]. In addition to this use of the aircraft, there were two other uses, specified by contract, which consumed a considerable amount of the time the aircraft were airborne. The aircraft were used to [Redacted]. Further, the aircraft were available for [Redacted].

There were separate management agreements for each aircraft. For the purpose of this decision, the differences among them are not relevant. Per the agreements, the taxpayer (owner) paid the manager as an [Redacted]. The aircraft were based in [Redacted] and served as the manager's first choice for charter operations when available. [Redacted].

Using flight hours and dividing them between qualifying and non-qualifying uses, the auditor calculated percentages, determining that for the test periods none of the aircraft were used more than 50 percent for an exempt purpose. The auditor and the taxpayer dispute what constitutes qualifying and non-qualifying uses. Further, there is a dispute over the definition of "primary" or "primary use" for the purpose of the exemption statute.

“Primary” and “primary use” are not defined in the sales tax code or administrative rules for the purpose of the claimed exemption, but the Commission sees no ambiguity. The Commission agrees with the auditor that unless the aircraft are used more than 50 percent of the time in an exempt capacity, their use does not qualify for the exemption.

The taxpayer contends that the greatest of all uses is the primary one. As a defense of its position, the taxpayer states that if there were several uses, none of which exceeded 50 percent, one use would nevertheless need to be designated as the primary one.

The Commission agrees that when there are several uses that can be measured numerically, one may stand out as exceeding all others. However, the Commission doesn’t agree that percentages of use should be measured individually against all other uses to determine a primary one. To do so might lead to an absurd result, such as allowing an exemption when a qualifying use was 10 percent of the total, for example.

Exemption statutes favor certain taxpayer behaviors. The Commission believes that the legislature wished to reward particular uses that were in the majority rather than merely higher than all other uses. Had it believed otherwise, it would have specifically stated so in the exemption statute. Nevertheless, should the court decide that the meaning of “primary” is ambiguous, there are Idaho court rulings that substantiate the Commission’s opinion:

It is a rule of statutory construction that tax exemptions exist only by legislative grace and are to be strictly construed against the party claiming the exemption. *Kwik Vend Inc. v. Koontz*, 94 Idaho 166, 483 P.2d 928 (1971); *Leonard Construction Company v. Idaho State Tax Commission*, 96 Idaho 893, 539 P.2d 246 (1975).

The Idaho Supreme Court further expressed:

If there is any ambiguity in the law concerning tax deductions, the law is to be construed strongly against the taxpayer. [Potlatch Corp. v. Idaho State Tax Comm’n, 128 Idaho 387, 913 P.2d 1157 (1996)] .Id. This Court has no authority to rewrite the tax code. *Bogner v. State Dep’t of Revenue and Taxation*, 107

Idaho 854, 693 P.2d 1056 (1984). Any exemption from taxation must be created or conferred in clear and plain language and cannot be made out by inference or implication. *Herndon v. West*, 87 Idaho 335, 393 P.2d 35 (1964). This Court does not have the authority to create deductions, exemptions, or tax credits. If the provisions of the tax code are socially or economically unsound, the power to correct it is legislative, not judicial. *Id.* *Idaho State Tax Commission v. Stang*, 135 Idaho 800, 25 P.3d 113 (2001).

The Tax Commission, therefore, is required to view exemptions narrowly, applying the rule of constraining the exemption in light of any ambiguity of the term “primary.”

There is additional evidence in favor of the Commission’s position. First, it knows of no exemption that favors the taxpayer’s reasoning. Further, where “primary” or “primarily” is defined in the sales and use tax administrative rules, it is defined as a qualifying use that exceeds 50 percent of the time (IDAPA 35.01.02.104.02.i. and 03.a.; Equipment necessary to, and primarily used in the process of, remanufacturing/rebuilding railroad rolling stock).

The following narrative expands on the three predominant uses of the aircraft mentioned previously. The appendix for this decision contains a usage chart for each aircraft.

**Charter Use:** The manager used the taxpayer's aircraft and its own pilots to provide charter flights for the public. The auditor, the Commission, and the taxpayer agree that such flights are what the claimed exemption intended.

**Taxpayer (Owner's) Use:** The taxpayer (i.e., the LLC principal), his employees, guests, and family flew in the aircraft. The Commission agrees with the auditor and the taxpayer that these are not qualifying exempt hours.

**Use by the Aircraft Manager for its Own Business Purposes:** The manager used the taxpayer's aircraft to transport its own employees for various purposes. The pilots were at all times the manager's employees. The manager is in the business of selling aircraft and used the taxpayer's craft when potential buyers were interested in identical or similar aircraft. The manager paid the taxpayer to use the aircraft for sales demonstration purposes. The pilot's fees were the responsibility of the manager, and the prospective buyers did not pay for the flights. Further, the manager's employees often flew to various locations for air shows and to conduct other business for the manager.

The Commission agrees with the auditor that the manager's flights, aside from public charters, do not qualify for the exemption, in part because the transactions are not arm's length. The manager cannot hire itself and is not being hired by passengers. Rather, the manager is directing its own employees. The entity flying the aircraft (the manager) pays for its employees to be on the aircraft; the employees pay nothing. Additionally, the manager's own use does not constitute indiscriminate availability to the public. The Commission concludes the manager's own use is not characteristic of charter flights in the ordinary use of that term.

Conversely, the taxpayer's view is literal. As paid-for flights, the taxpayer believes all of the manager's uses qualify as exempt. The manager paid the taxpayer for the use of the aircraft regardless of flight purpose or occupants, although the amount varied by use. In the taxpayer's opinion, regardless of who pays, how much is paid, or a flight's purpose, if a flight takes a person from Point A and lands at Point B, the flight qualifies as exempt, unless it is a use by the taxpayer (owner).

There are ancillary issues associated with each of the three use categories described above. For example, a one-way flight still requires a return flight to the manager's base, where the aircraft awaits its next use. This is referred to as a repositioning flight. The auditor and the Commission believe that for all flights that qualify for the exemption, the repositioning flight qualifies as well. The return leg of a non-qualifying flight, however, should not qualify because it is an act of the manager's volition. If the manager uses the aircraft in a non-qualifying capacity, no time requirement arising from it should count as qualifying.

The taxpayer disagrees. The base of operation is where the craft awaits a paying customer. Any flight that returns to the base should be qualifying, according to the taxpayer.

#### Analysis and Conclusion

The definition of "sale" as it pertains to a taxable sale was amended effective April 1, 1988, to include receipts from intrastate charter flights (Idaho Code § 63-3612(i)). The taxpayer's claimed exemption for aircraft primarily used to transport passengers or freight for hire became effective that same day. The exemption statute followed logically from the inclusion of intrastate charter flights as taxable, because the legislature intended that "[t]he definition of retail sale, upon which tax is imposed.... apply only to sales to ultimate consumers" (House Revenue and Taxation Committee Report in Support of House Bill 222, enacting the

Idaho Sales and Use Tax Act, 1965). Thus, from 1988, aircraft could be purchased tax exempt if they were primarily used to provide flights that were taxable.

In 1994, a federal law was enacted prohibiting states from taxing sales of air transportation (49 U.S.C. Section 40116). While the provisions of Idaho Code § 63-3612(i) pertaining to taxing intrastate charter flights were rendered unenforceable by this federal law, the exemption statute was not repealed by the legislature. However, the Commission believes that the exemption statute should be viewed from its historical perspective. Under those assumptions, it believes the piloting of an aircraft by a manager for the purpose of transporting its own employees was not intended as a charter flight for the purposes of the exemption.

The legislature intended that the purchase of an aircraft for one's personal or business use was taxable, as evidenced by the absence of an exemption for such a purpose. The taxpayer in this case bought aircraft tax-free for personal and business use, nevertheless intending that its majority use would qualify for the exemption.

The Commission believes that the arrangement whereby a third-party manages the aircraft and makes use of it for its own business (not including charter for the purpose of raising revenue) is a non-qualifying use under the exemption statute. If the taxpayer were to prevail in its arguments, the manager need not make the aircraft available for indiscriminate charter use at all. Since the taxpayer believes any management use of the craft qualifies, the majority use can be the manager's personal business use and the minority use can be the taxpayer's. A structure of this sort, however, is to allow two entities together to do what no single entity can do without tax consequences, i.e., buy an aircraft tax-free for personal or business use that does not involve public charter.



The qualifying percentages based on the preceding designations for total flight time and qualifying flight time for three aircraft in the order of their purchase are: 42.8 percent, 42.4 percent, and 46.1 percent. All are beneath the over-50 percent threshold established for the exemption.

The taxpayer's calculation of qualifying hours exceed 50 percent for each aircraft's use, ranging from approximately 59 percent to 76 percent under the previously discussed premise that flight hours for which the taxpayer is compensated by the manager are qualifying.

Additionally, and as noted previously, the taxpayer contends that it need not achieve 59 percent to 76 percent under its definitions to qualify for the exemption since the manager holds out each aircraft to the public as available for charter. Compared to the hours used by the manager itself and the hours used by the taxpayer, the primary use, meaning the use that exceeds all others, is still transporting passengers and freight for hire, according to the taxpayer.

As discussed, the basis of the Commission's decision is its interpretation of Idaho Code § 63-3622GG. This statute was amended effective July 1, 2009, during the period under audit, which began in May 2003 and ended December 2009. Only the third of the three aircraft at issue operated in the post-amendment period. The differences in the relevant parts of the Code sections are contrasted below:

**Current:** Aircraft. There is exempted from the taxes imposed by this chapter:

- (1) The sale, lease, purchase, or use of aircraft primarily used to provide passenger or freight services for hire as a common carrier only if:
  - (a) The person operates the aircraft under the authority of the laws of this state, the United States or any foreign government; and
  - (b) The aircraft is used to provide services indiscriminately to the public; and
  - (c) The aircraft itself transports the person or property from one (1) location on the ground or water to another (Idaho Code § 63-3622GG, effective from July 1, 2009).

**Prior:** Aircraft. There is exempted from the taxes imposed by this chapter:

(1) The sale, lease, purchase, or use of aircraft primarily used to transport passengers or freight for hire..... (Idaho Code § 63-3622GG, effective to June 30, 2009).

The Commission's administrative rule in effect during the latter part of the audit period follows, in relevant part:

Transportation of freight or passengers for hire. For the purposes of this rule, "transportation of freight or passengers for hire" means the business of transporting persons or property for compensation. Such transportation must be offered to the general public. Entities such as LLCs or closely held corporations that only transport related parties, including but not limited to employees or family members of the owner of the aircraft are not in the business of transporting freight or passengers for hire. (IDAPA 35.01.02. 037.01.g. effective from 3-30-07 to 3-29-10).

The Commission believes that under the language of the current and prior statute and the existing administrative rule, the exemption was not intended to apply to the use of aircraft by its owner or closely related entities for its own purposes. As noted earlier, the taxpayer's central disagreement is the Commission's exclusion of the aircraft manager's own use of the aircraft as qualifying hours. As the rule previously cited notes, an LLC's related parties are not limited to employees or family members. The Commission contends that the aircraft manager is a related entity and that the manager's use of the aircraft for its own purposes doesn't qualify as a charter flight, regardless of compensation.

A contributing factor to the auditor's segregation of flights between qualifying and non-qualifying is the taxpayer's flight log notations. The auditor notes that two different FAA certifications were used to classify air flight. At the elemental level, Part 135 certification is for a commercial or charter (i.e., paid) operation and Part 91 is for private operations (See, in general, "Part 91 and 135 Operations: An Important Difference." Kevin M. Reynolds, Whitfield & Eddy, PLC. Des Moines, Iowa. Undated.).

According to the auditor, the manager's flights for its own use were always logged as Part 91. When the manager was hired to perform a charter flight for the public, the log notation was Part 135. Regardless of how the manager used the aircraft, for itself or the public, the payment to the taxpayer at least covered an agreed upon fee as a "bare rental" (craft without pilot). Consistent with the FAA definitions, the auditor held flights logged Part 91 as non-qualifying.

Stressing that Part 91 vs. Part 135 distinctions are not referenced in the exemption statute, the taxpayer believes that the nature of the flight determines its qualification for the exemption, rather than the federal designation. If a paid flight takes a person from point A to point B, but by federal regulation it can or must be classified as Part 91, the taxpayer still believes it qualifies toward the exempt use determination. Overall, the taxpayer's view is that charter hours are determined by an exchange of money, not by how much money or who is flying in the aircraft.

The Commission believes that while inconclusive by itself, this federally mandated distinction is instructive. These distinctions are important to the federal government, and the Commission believes it is reasonable to preliminarily judge whether a flight qualifies for the exemption by seeing if it is classified as commercial and charter use rather than as personal use.

The liability has been adjusted in the taxpayer's favor for the following reasons. Sales and use taxes owed to the state are due on or before the twentieth day of the month following the transaction or use giving rise to the tax. For use tax, a return shall be filed by every retailer and every person purchasing tangible personal property subject to use tax who has not paid tax to a retailer required to collect the tax (Idaho Code § 63-3623 (a) and (d)).

In the case of taxes owed by a person who has failed to file, the amount shall be assessed within seven (7) years of the time the return upon which the tax asserted to be due should have been filed (Idaho Code § 63-3633(c)).

Aircraft [Redacted] was purchased on December 21, 2001. The taxpayer did not have a sales tax permit, often referred to as a seller's permit, at this time, nor did it have one during the audit period. Tax was due on the transaction no later than January 20, 2002. The assessment, dated June 21, 2010, is beyond the statutory period.

Had audit evidence concluded that the aircraft use qualified for the exemption from the purchase date to May 1, 2003, and later did not qualify, tax would have been due on that later date which would have been within the statutory period for an assessment. Absent that evidence, the Commission will remove the liability associated with the use.

On October 20, 2004, the taxpayer bought aircraft [Redacted] in a transaction involving the trade-in of aircraft [Redacted]. The auditor concluded that the aircraft's use never qualified for an exemption. Had the taxpayer paid tax on the purchase date, the sales price subject to tax would have been net of the trade-in value because the retailer took the aircraft into its resale inventory (Idaho Code § 63-3613(b)2). The Commission believes that this, rather than the fair market value, is the appropriate taxable amount.

On November 29, 2007, the taxpayer bought aircraft [Redacted] using the proceeds of the sale of aircraft [Redacted]. There was no trade-in because the purchase was arranged by a like-kind exchange facilitator who sold the prior aircraft in a separate transaction. This decision holds the purchase price of the new aircraft subject to tax, rather than the auditor's fair market value, although the difference is relatively minimal.

THEREFORE, the Notice of Deficiency Determination dated June 21, 2010, is MODIFIED, and as modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax and interest:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$225,381	\$35,127	\$260,508

Interest is calculated through August 31, 2011, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2011.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

#### **CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2011, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.  
  
\_\_\_\_\_