

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24241
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

On May 23, 2011, 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, penalty, and interest for the period January 1, 2007, through December 31, 2010, in the total amount of \$217,504.

On July 25, 2011, the taxpayer filed a timely appeal and petition for redetermination of the Notice. On October 25, 2011, at the taxpayer’s request, the Commission held an informal hearing. For the reasons that follow, the Commission modifies the audit findings in the taxpayer’s favor.

Background

The taxpayer is a limited liability company (LLC). The members are a married couple, both residents of [Redacted]. The LLC registered in [Redacted] with the Idaho Secretary of State but was formed under [Redacted] law.

The taxpayer has [Redacted], describing itself as a [Redacted] service. The auditor questioned the taxpayer’s [Redacted] that were used under contract with the federal government for [Redacted] during the audit period. The taxpayer claims a use tax exemption under Idaho Code § 63-3622GG which exempts [Redacted]. The taxpayer simultaneously claimed a resale exemption for many of the [Redacted]. Property held for resale is not subject to tax (Idaho Code § 63-3609).

The auditor asserts that the taxpayer had significant contact and consistent operations in this state to render it a resident for the purpose of owing use tax on the purchase price or value of the [Redacted] under a statute that imposes use tax when tangible personal property first enters the state (Idaho Code § 63-3621). Further, the auditor relied on the statute that defines tax obligations with respect to aircraft and the administrative rule that interprets the [Redacted] statute (Idaho Code § 63-3622GG and IDAPA 35.01.02.037). Finally, the auditor asserted that the resale exemption the taxpayer claimed under Idaho Code § 63-3609 did not apply, as the [Redacted] were not held for resale but were used under the provisions of a contracting service.

Relevant Tax Statutes and Administrative Rules

In Idaho, the sale, purchase, and use of tangible personal property is subject to tax unless an exemption applies. If sales tax cannot or is not paid to the vendor, the buyer owes a use tax to the state. Payment of use tax extinguishes the sales tax obligation (Idaho Code §§ 63-3612 and 63-3621). The taxpayer makes no claim that it has paid Idaho tax. Rather, it claims that tax is not due and provides a variety of defenses.

Tax, as applied to the sale, purchase, and use of aircraft in Idaho, is governed by a statute that has changed in the past several years. The following version, in relevant part, was effective until June 30, 2009, and was therefore applicable to the purchase dates of all aircraft held for liability in this decision.

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 following version, in relevant part, was effective from July 1, 2009, and is current as of this writing:

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).

The two versions are relevant to the audit findings from the taxpayer's perspective, as explained below in the Taxpayer's Protest and Analysis.

The following subsection of the previously cited code refers to the limitations of non-residents' use of aircraft in Idaho relative to a use tax obligation. While the paragraph numbering has changed, the language has been part of the code since 1994:

- (3) The sale, lease or purchase of aircraft for use outside this state by nonresidents, even though delivery be made within this state, but only when:
 - (a) The aircraft will be taken from the point of delivery to a point outside this state;
 - (b) The aircraft will not be used in this state more than ninety (90) days in any twelve (12) month period.

Taxpayer's Protest and Analysis

The numbered, single-spaced, italicized paragraphs are issues raised by the taxpayer, and the text that follows is the Commission's analysis and conclusion.

1. [Redacted] aircraft are beyond the statute of limitations bar.

The Commission must assess tax within three years after the due date of the return to which the purchase or use is subject to tax or the date the return was filed, whichever is the later. In the case of taxes owed by a person who has failed to file a return, tax must be assessed within

seven years of the time the return upon which the tax asserted was due should have been filed (Idaho Code § 63-3633(a) and (c)).

Use tax can only be imposed if goods enter the state and no exemption applies (Idaho Code § 63-3621). Without evidence to the contrary, the Commission relies on the purchase date as the first use in Idaho, presumes that the first use was taxable, and measures the statute of limitation from that date.

For that reason, the Commission modifies the auditor's findings by removing the liability of all aircraft with a purchase date prior to seven years from the beginning of the audit period, January 1, 2007. Further, since the audit period defines the scope of the examination, the Commission removes all aircraft bought before the beginning date of the audit period. Three aircraft remain and are the subject of this decision.

2. The LLC members are [Redacted] residents, and the LLC has no significant contact or consistent operations with or in Idaho. It was not required to register with the Idaho Secretary of State (although it did) and was a non-resident for the audit period.

For the adjusted liability that pertains to the three aircraft, the Commission need not refute the taxpayer's claim that it is not a resident. Non-residents owe tax on the value of aircraft if in-state use exceeds 90 days in any 12-month period (Idaho Code § 63-3622GG(3)(b)). The three aircraft exceeded the exemption threshold, according to the auditor's review of flight logs.

3. At all times, the taxpayer was under contract with the federal government for [Redacted] activities which consisted of charter flights at the direction of the government.

The taxpayer maintains that all use of aircraft involving the federal government's [Redacted] efforts qualify as "primarily used to transport passengers or freight for hire" as evidenced by its Federal Aviation Administration (FAA) certification as authorized in the Code of Federal Regulations (14 CFR 135).

In a prior Commission decision (Docket No. 20307, issued 5/30/2008), the Commission asserted that flying for the government under contract was a service, although it has some elements of charter flight. As the Commission understands [Redacted]contracts from its prior decision, the flight service provider is not guaranteed, under the terms of a contract, that it will perform any particular function. Rather, it maintains a readiness and performs whatever flight tasks are ordered. This is substantially different from the ordinary understanding of a freight and passenger charter business, where a customer specifies a desire for transportation between points.

While the Commission believes that firefighting under contract with the government is not a qualifying exempt use of aircraft, it does not rely solely on that presumption to assert tax in this case. The auditor examined all flights within a 12-month test period for the three aircraft in question, guided by Idaho Code § 63-3622GG and as interpreted in IDAPA 35.01.02.037. The taxpayer objects to the test periods, calling them arbitrary, but the Commission presumes that the aircraft must be continuously conforming to the exemption criteria to qualify.

There are varied activities in pursuit of [Redacted].

The auditor examined flight logs and determined which flights qualified as transportation of passengers or freight for hire and those that did not, concluding that qualifying use of each aircraft measured in flight hours did not exceed 50 percent, and that the three aircraft, therefore, did not qualify for the “passenger or freight services for hire” exemption cited previously, Idaho Code § 63-3622GG(1).

Qualifying flight criteria for the tax exemption are enumerated in the following administrative rule. Note that the dates in parentheses following the subsections indicate the time they were effective or modified into their current form. For those displayed below, all dates precede the dates the three aircraft in question were purchased:

...

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.... (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...(3-4-10) [Note: the provision of offering the flights to the general public was added effective 3/30/2007].

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)...

...

c. Purchased for use outside this state, when the aircraft is upon delivery taken outside this state, but only if: (3-20-04)

...

i. .. the aircraft will not be used in this state more than ninety (90) days in any twelve (12) month period. (3-20-04)

...

05. Aerial Contracting Services. Businesses primarily engaged in the application of agricultural chemicals as described in Federal Aviation Regulation Part 137, or in activities involving the carrying of external loads as described in Federal Aviation Regulation Part 133, such as aerial logging, are performing aerial contracting services. Such businesses are not primarily engaged in the transportation of freight. (4-11-06)

a. Aircraft purchased, rented, or leased for aerial contracting are subject to sales tax. It makes no difference whether or not the service is provided to a government agency or a private individual or company. Sales or use tax also

applies to the purchase of repair parts, oil, and other tangible personal property.
(7-1-94)

(IDAPA 35.01.02.037, excerpted in pertinent part.)

For the purpose of determining qualifying and non-qualifying uses of the aircraft, maintenance and test flights were excluded from the evaluation under the assumption that all aircraft must be used for these purposes. Based on the results of the examination, the exclusion of these few flight hours had no bearing on the outcome.

Using the previously cited IDAPA 35.01.02.037 as a guide, flights which had one or more contracting government agency employee or freight on board and had a beginning location different from the terminal location were accepted as flights that qualified for the exemption. Flights that began and terminated at the same airport were considered non-qualifying. Flights with no passengers or freight and those undertaken for the purpose of repositioning the aircraft for a future use were also considered non-qualifying.

Based on the evaluation criteria, the auditor concluded that the aircraft identified as N^[Redacted] had 24 percent qualifying hours; aircraft N^[Redacted] had 0 percent qualifying hours; and N^[Redacted] had 27 percent qualifying hours. The Commission agrees with the auditor that under the most liberal interpretation of “primary use,” a phrase not defined in the code or administrative rules for the purpose of determining the exemption sought, none of the three aircraft qualifies as “primarily used to transport passengers or freight for hire.”

Further, each aircraft was purchased after the effective date of an administrative rule change that stipulated aircraft service must be available to the public. There is no evidence that the three aircraft at issue are available for charter by the public.

4. Idaho Code § 63-3622GG and Rule 037 [IDAPA 35.01.02.037]. The flights for the federal government constitute transportation of persons and freight for hire, hence the exemption applies. Portions of Rule 037 are overreaching the statute and are invalid. Specifically, the

taxpayer objects to Rule 037.01.c: “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.”

The Idaho legislature saw fit to accept administrative rules that satisfied its need to interpret the underlying statute.

5. Related to the above, the taxpayer notes the July 2009 change in Idaho Code § 63-3622GG. In the prior version, there is no mention that only flights from “Point A to Point B” are within the definition of “transportation for hire. As the prior code should be applied to the audit findings, the auditor is overreaching in the current case.

The Commission agrees that there was no expanded definition in the code until 2009, but contends that the legislature approved of the Commission’s interpretation in the administrative rule.

6. Commerce clause and interstate commerce—due to its multi-state availability for flights under the direction of federal contracts, the imposition of tax in this audit places an impermissible burden on interstate commerce.

The taxpayer has not referenced any United States code that prohibits a state from imposing sales and use tax on the purchase and use of goods by contractors in fulfillment of a federal contract. Further, the Commission presumes that statutes enacted by the Idaho legislature are not in violation of the Constitution or any United States code section.

Specifically, the Commission presumes that the Idaho legislature believed more than 90 days’ presence in Idaho was an adequate measure of “substantial nexus,” mentioned by the taxpayer, as a condition sufficient to impose a state use tax. While the Commission is well aware of “substantial nexus” requirements, it knows of no statute or federal court case that precisely defines it or prohibits use of the threshold established in Idaho Code § 63-3622GG.

With respect to interstate commerce, the taxpayer warns that the imposition of tax on its use of aircraft in Idaho to [Redacted] could dampen its desire to enter the state, thus jeopardizing

the state's goal to [Redacted]. The Commission is not persuaded that it can rely on such information in deciding this case. The Commission is an administrative body that enforces the tax code. The legislative body enacts taxes and thereby influences behavior. It is rightly within the legislative's responsibility to address this issue if it sees fit.

7. Idaho Code § 63-3621. The aircraft in question were not acquired for storage, use or other consumption in Idaho. Rather, they were purchased for use throughout the United States to be used under contract with the federal government. Additionally, the imposition of tax is barred by 49 USC § 40116 (prohibition of taxation on interstate flights).

The Commission agrees that charges for flights *per se* are not taxable, as acknowledged in IDAPA 35.01.02.037.03. However, the audit findings do not impose a tax on the sales price of charter flights, nor does it impose a state tax on the federal government, which is also prohibited. Rather, it imposes a tax on the taxpayer's use of aircraft in this state. It does not matter that the aircraft were or could have been used anywhere in the United States. The aircraft subject to the assessment of tax, after accounting for the adjustments to the findings described previously, were used in this state more than 90 days in a 12-month period for a non-exempt purpose. The Commission does not question that the threshold of use in this state set in place by the legislature violates interstate commerce considerations.

The Commission does not contend that other taxing states may have legitimate claims to tax on the aircrafts' operations in those states. Had any other state having a right to do so imposed and collected its tax on the use of the aircraft, the Commission would give credit up to the amount owed to this state (Idaho Code § 63-3621(j)).

The taxpayer appears to be saying that since the aircraft can be used virtually anywhere, nor jurisdiction can lay claim to it for the imposition of state taxes. The taxpayer has not provided any argument to substantiate this claim.

8. *The taxpayer maintains that the aircraft are held for resale and are therefore not subject to tax (Idaho Code § 63-3609).*

In its protest letter, the taxpayer did not defend an assertion that the use of the aircraft was not subject to tax under the assumption that the aircraft were held for resale. However, the auditor was made aware of this defense during field work.

It may be that the taxpayer believed it was selling the use of the aircraft to the government under its contracts, but since the taxpayer piloted the aircraft, this is a service and not the exchange of tangible personal property (i.e., sale, rental, or lease of an aircraft without a pilot) for a consideration, which is the definition of a taxable retail sale, in the absence of an exemption (Idaho Code § 63-3612). Further, the taxpayer accounted for its aircraft as business assets rather than resale inventory.

Valuations

The three aircraft are identified as follows, with purchase dates in parentheses: [Redacted]. The auditor determined that the purchase price subject to tax for the [Redacted] each. Valuation for the purpose of imposing a use tax is defined in Idaho Code § 63-3621, which states “a recent sales price shall be presumptive evidence of the value of the property.” Lacking a purchase document, the auditor determined that the fair market value of the third aircraft, [Redacted]. In the absence of an invoice or a recent sales price, “the value of the property subject to the use tax will be the fair market value at the time of first use in Idaho” (IDAPA 35.01.02. 072.01).

Conclusion

The taxpayer did not provide evidence adequate to establish that the amount asserted in the Notice is incorrect. As a result, the Commission will uphold the Notice. A determination of the State Tax Commission is presumed to be correct (Albertson's, Inc. v. State, Dept. of

Revenue, 106 Idaho 810, 814, 683 P.2d 846, 850 1984), and the burden is on the taxpayer to show that the deficiency is erroneous (Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2 Ct. App. 1986.)

Absent information to the contrary, the Commission finds the deficiency prepared by the Bureau to be a reasonably accurate representation of the taxpayer's use tax liability for the period January 1, 2007, through December 31, 2010.

The Bureau added interest and penalty to the use tax deficiency. The Commission reviewed those additions, found both to be appropriate per Idaho Code §§ 63-3045 and 63-3046, and has updated interest accordingly. Interest is calculated through July 31, 2012, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated May 23, 2011, is hereby MODIFIED, in accordance with the provisions of this decision, and, as MODIFIED, is AFFIRMED and MADE FINAL.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$54,000	\$13,500	\$10,626	\$78,126

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 _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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.