

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-859-267-072
[Redacted]	)	
	)	
Petitioner.	)	DECISION
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On July 22, 2016, the staff of the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (Petitioner), proposing use tax, penalty, and interest for the period December 1, 2015, through December 31, 2015, in the total amount of \$90,060.

On September 19, 2016, Petitioner filed a timely appeal and petition for redetermination of the Notice. At Petitioner’s request, the Commission held an informal hearing on June 20, 2017. Following the hearing, Petitioner corresponded with the Commission on July 12, 2017, and October 9, 2017.

In November 2017, the Bureau determined an administrative error was made on the Notice issued to Petitioner on July 22, 2016. As a result, the Notice was cancelled. A new Notice was issued to Petitioner on December 1, 2017, proposing use tax, penalty, and interest for the period December 1, 2015, through March 31, 2016, in the total amount of \$92,916. Petitioner filed a timely protest of this Notice on December 12, 2017. In its protest, Petitioner stated that it did not request another informal hearing, and asked the Commission to consider the information provided at the previously held informal hearing and thereafter when rendering a decision. The Commission, having reviewed the audit file, information obtained at the hearing, and correspondence submitted thereafter, hereby issues its decision to uphold the Notice.

**Background and Audit Findings**

On December 30, 2015, Petitioner purchased a 2015 Piper aircraft, registration number

[Redacted] for \$1,393,260, taking delivery from a nonresident seller outside Idaho. Petitioner then relocated the aircraft to a leased hangar in [Redacted] Oregon, and changed the registration number to [Redacted]. The aircraft first entered Idaho on January 20, 2016. The Bureau mailed a questionnaire to Petitioner on February 9, 2016, to determine the taxability of the aircraft in Idaho. Petitioner responded to the request on March 16, 2016, stating no sales tax was paid on the purchase of the aircraft and claiming an exemption for resale, as Petitioner held the aircraft for resale and used it primarily for rent or lease to others. Petitioner and the Bureau exchanged additional correspondence regarding the aircraft, including copies of the purchase agreement, flight logs, hangar lease agreement, and maintenance records. The Bureau determined that no exemption applied for the aircraft, and issued a Notice for sales tax calculated on the purchase price of the aircraft, plus penalty and interest.

#### **Petitioner's Protest**

Petitioner's initial protest, dated September 19, 2016, contended that Petitioner was a nonresident of Idaho and did not have nexus sufficient to permit taxation of the aircraft in Idaho. This initial protest did not reference a lease agreement between Petitioner and any other party.

On April 18, 2017, Petitioner submitted an amended protest indicating it had elected to pay Idaho sales tax on the rental of the subject aircraft. With this amended protest, Petitioner included an Aircraft Lease Agreement (Lease) executed on February 28, 2017, to be effective as of August 10, 2016.

#### **Relevant Tax Code and Analysis**

In Idaho, a tax is imposed on the sale of tangible personal property unless an exemption applies. Idaho Code § 63-3612(1). Idaho retailers collect sales tax from the buyer and remit it to the state. Idaho Code § 63-3619. When a taxable sale is made by a vendor who is not obligated

by law to collect Idaho sales tax from an Idaho resident, no tax is collected. Use tax, the complementary tax to sales tax, is due in these circumstances, and it is the responsibility of the buyer to remit the tax to the state. Idaho Code § 63-3621. The sales tax and use tax rates are identical, six percent of the purchase price. Idaho Code §§ 63-3619 and 63-3621.

An exemption from sales tax and use tax is available on the sale, lease, or purchase of aircraft for use outside Idaho by nonresidents, even though delivery may be made within Idaho, when the aircraft will be taken outside Idaho and not be used in Idaho more than ninety (90) days in any twelve (12) month period. Idaho Code § 63-3622GG(3). IDAPA 35.01.02.037.01.e (4-4-13) defines “Nonresident Businesses and Other Organizations” as follows:

A corporation, partnership, limited liability company, or other organization will be considered a nonresident if it is not formed under the laws of the state of Idaho, is not required to be registered to do business with the Idaho Secretary of State, does not have significant contacts with this state, and does not have consistent operations in this state. A limited liability company (LLC) or other legal entity formed by an Idaho resident under the laws of another state primarily for the purpose of purchasing and owning one (1) or more aircraft is not a nonresident. The use of an aircraft owned by such an entity will be subject to use tax upon its first use in Idaho.

Petitioner’s initial protest claimed Petitioner was a nonresident of Idaho, and therefore the aircraft would not be subject to Idaho sales tax or use tax. The Commission believes Petitioner has abandoned this argument; Petitioner did not address its residency in its amended protest dated April 18, 2017, during the informal hearing in June 2017, or in its protest dated December 12, 2017. The Commission considered Petitioner’s presence in Idaho relative to the criteria set forth in State Tax Commission Rule 37.01.e, and concluded Petitioner did not qualify as a nonresident business or other organization for the purposes of Idaho Code § 63-3622GG(3) and State Tax Commission Rule 37.01.e.

Petitioner is a Limited Liability Company organized in the state of Washington, and is

currently registered with the Idaho Secretary of State. Two of Petitioner's subsidiaries are organized under the laws of Idaho. Petitioner maintains business locations in several states, including Idaho, and has maintained an Idaho seller's permit with a quarterly filing responsibility since May 1, 2013. The Lease executed by Petitioner identifies Petitioner's principal place of business as being within Idaho.

The Commission also considered Petitioner's presence in Idaho relative to the four-part test set forth in *Complete Auto Transit, Inc. v. Brady* 134 S. Ct 746 (1977), and determined the tax proposed by the Bureau did not represent a violation of the Commerce Clause. Petitioner is an Idaho retailer, with a business location in Idaho and multiple subsidiaries organized under Idaho laws. Petitioner elected to store and use the aircraft within Idaho. Petitioner's storage and use of the aircraft within Idaho, in furtherance of its retail business and while enjoying the benefits of the state, establishes Idaho as a constitutional taxing jurisdiction.

The lease or rental of tangible personal property is a sale. Idaho Code § 63-3612(2)(h). Idaho Code § 63-3613(a) provides "The term "sales price" means the total amount for which tangible personal property, including services agreed to be rendered as part of the sale, is sold, rented, or leased, valued in money, whether paid in money or otherwise..." The taxability of rented or leased tangible personal property is dependent upon whether the transaction is a bare equipment rental or a fully operated equipment rental. An owner who makes bare equipment rentals may purchase equipment without paying sales tax or use tax, and must collect sales tax on each rental payment. IDAPA 35.01.02.024.02. A fully operated equipment rental, where the equipment owner supplies the equipment along with an operator, is a service rather than a retail sale, and no sales tax is due on a fully operated equipment rental. The owner or supplier of the tangible personal property used in a fully operated equipment rental is the consumer of the

equipment or property; therefore, the owner's purchase of the equipment or property is subject to sales tax or use tax upon purchase or first use in Idaho. IDAPA 35.01.02.024.03.

Petitioner's amended protest contends that Petitioner has elected to pay Idaho sales tax on the rental of the subject aircraft as a bare equipment rental in accordance with IDAPA 35.01.02.024. In support of its argument, Petitioner submitted copies of a lease agreement; an aircraft management agreement; a copy of the questionnaire originally provided to the Bureau; an email from [Redacted]; and a worksheet of lease payments.

The Lease submitted by Petitioner states it was executed on February 28, 2017, to be effective August 10, 2016. The terms of the Lease provide that Petitioner, whose principal office is located within Idaho, will lease the aircraft to itself and four subsidiaries (Lessees), two of which are organized under the laws of the State of Idaho. The aircraft is to be used by the Lessees on company flights. The Lease has an initial five-year term, and Lessees are required to make payments equal to \$232,210 annually by March 15 of each year. If a Lessee defaults, a penalty of \$10 is imposed unless Lessee obtains written permission from Petitioner to make late payments. Lessees are responsible for the fees shown in the Aircraft Management Agreement (Agreement) and all taxes payable with regard to the aircraft.

The Agreement, incorporated into the Lease as Schedule A, is between [Redacted], Inc. and Petitioner. [Redacted] is an entity unrelated to Petitioner, located in [Redacted] Idaho, and is in the business of managing, chartering, operating, and maintaining aircraft. In the Agreement, Petitioner agrees to pay [Redacted] for certain services related to its aircraft, including the employment and supervision of flight and maintenance personnel assigned to the aircraft; FAA liaison and compliance; record keeping and budgeting; and management of scheduling, operation, and maintenance. Specifically, [Redacted] will supply Petitioner with

qualified pilots and support personnel such that the aircraft may be maintained and operated in accordance with FAA regulations. Petitioner is required to pay [Redacted] \$9,350 per month for fixed costs, which includes a management fee, insurance, hangar rent, and pilot salary and benefits. Petitioner is also obligated to reimburse [Redacted] for variable expenses related to the use of the aircraft, including fuel, parts, catering, ground transportation, and fees charged while en-route. None of the Lessees are named in the Agreement, and the Agreement specifies the operating base of Petitioner's aircraft is [Redacted] Idaho. During the informal hearing, Petitioner stated that it pays [Redacted] for all management charges related to the aircraft, then seeks reimbursement from the Lessees. The Commission requested written documentation of the reimbursement, but did not receive any additional information.

Petitioner purchased the aircraft in December 2015, well before the intended effective date shown in the Lease of August 10, 2016, and over one year prior to the execution date of February 27, 2017. A review of the aircraft logs indicates Petitioner's aircraft first entered Idaho on January 20, 2016. These same logs indicate that between December 30, 2015, and April 13, 2016, the aircraft was in Idaho for purposes other than maintenance for a total of 12 days.

During the informal hearing, Petitioner stated an oral agreement existed between Petitioner and the Lessees regarding the aircraft prior to the execution of the written Lease. According to Petitioner, this oral agreement was confirmed in an email. Petitioner submitted a copy of the email, originally sent on June 15, 2016, to Petitioner by a representative of [Redacted], which states the following:

What most people will do is set up an ownership structure so that you are leasing back the aircraft from another entity. If done properly this structure allows for the state to collect tax on a per hour basis which is almost always beneficial to the owner as the end result is much less than the upfront sales tax for Idaho. I would be happy to refer you to an aviation tax consultant if needed.

On May 24, 2017, Petitioner submitted payment to the Commission in the amount of \$9,896.33. According to Petitioner, this payment represents the sales tax due on total lease payments in 2016 of \$164,938.96. During the informal hearing, the Commission requested written documentation of all lease payments made by the Lessees to Petitioner. Petitioner submitted a worksheet indicating two lease payments were received on March 15, 2017, each from a single Lessee, in the amounts of \$44,550.52 and \$11,562.73. Petitioner's sales tax return for the quarter ending March 31, 2017, did not report any taxable sales, and no sales tax has been paid to the Commission for the lease payments received in 2017. Petitioner did not provide any documentation for the lease payments it states were received from the Lessees in 2016.

There is scant evidence available to the Commission to indicate Petitioner initially purchased the aircraft for resale. The Commission finds Petitioner purchased the aircraft for its own use, and the Lease is not recognized by the Commission. The Lease executed by Petitioner was signed approximately one year after Petitioner first brought the aircraft into Idaho, and Petitioner has failed to provide adequate documentation to substantiate that Petitioner and Lessees adhered to the terms of the Lease when utilizing the aircraft. The lease payments allegedly made in 2016, upon which Petitioner submitted a payment of sales tax in May 2017, are undocumented. The business records provided by Petitioner to document the lease payments collected from two of the five Lessees on March 15, 2017, do not indicate if Petitioner collected sales tax on the lease payments, and Petitioner did not report or remit sales tax for these lease payments on its sales tax and use tax return for the corresponding period.

The email exchanged between Petitioner and [Redacted] depicts the Lease as an attempt to structure Petitioner's use of its aircraft so as not to incur Idaho sales tax or use tax. A lease agreement executed at any point after Petitioner's first use of the aircraft in Idaho would not

relieve Petitioner of the use tax due on the entire value of the aircraft. Petitioner claims an oral lease was in place prior to the execution of the Lease in February 2017. However, Petitioner documented via its own email that it was first made aware of the possibility to lease the aircraft so as not to incur Idaho sales tax or use tax on the full purchase price, in June 2016, several months after Petitioner first brought the aircraft into Idaho. Even if the resulting Lease was determined to be valid retroactive to August 10, 2016, the aircraft's flight logs documented Petitioner's use of the aircraft in Idaho prior to that date, with several trips into Idaho for a purpose other than maintenance within two months of purchasing the aircraft. Considering the timing of the date Petitioner first brought the aircraft into Idaho (January 2016), and the date Petitioner was advised of the potential for leasing the aircraft to itself (June 2016), there is no possibility that any lease agreement was in effect prior to Petitioner's first use of the aircraft in Idaho. Petitioner does not qualify as a nonresident of Idaho, given the provisions of IDAPA 35.01.02.037.01.e and the Lease identifying Petitioner's principal place of business within Idaho; therefore, the aircraft is subject to use tax upon Petitioner's first use in this state, prior to Petitioner's email exchange with [Redacted] and the retroactive date asserted on the Lease.

Even if Petitioner had entered into the Lease in a timely fashion, and could substantiate the executed Lease as more than an arrangement among its own entities, the Commission finds Petitioner still would not qualify to purchase the aircraft exempt from tax for use as a bare equipment rental. Petitioner contends in its protest that the Lease constituted a bare equipment rental. However, the Agreement between Petitioner and [Redacted] specifies that [Redacted] will provide, among other things, a flight crew to pilot the aircraft, and Petitioner is responsible for the associated cost. Using [Redacted] as its agent, Petitioner supplied the aircraft to the Lessees with a flight crew, thereby meeting the criteria of IDAPA 35.01.02.024 as

a fully operated rental. There is no evidence that any entity other than Petitioner paid [Redacted] for the flight crew necessary to operate the aircraft, or that any Lessee ever reimbursed Petitioner for the costs shown in the Agreement. Petitioner's leasing of the plane to its subsidiaries would have constituted a service, not subject to sales tax. As such, Petitioner would be required to pay sales tax or use tax at the time Petitioner commenced use of the aircraft in Idaho as fully operated rental property.

### **Conclusion**

On appeal, a deficiency determination issued by the Tax Commission "is presumed to be correct, and the burden is on the taxpayer to show that the Commission's decision is erroneous." *Parker v. Idaho State Tax Comm'n*, 148 Idaho 842, 845, 230 P.3d 734, 737 (2010) (citing *Albertson's Inc. v. State Dep't of Revenue*, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984)). The Commission requires Petitioner to provide adequate evidence to establish that the amount asserted in the Notice is incorrect. Here, Petitioner did not provide adequate evidence. As a result, the Commission will uphold the Notice.

Absent information to the contrary, the Commission finds the Notice prepared by the Bureau to be a reasonably accurate representation of Petitioner's sales tax and use tax liability for the period December 1, 2015, through December 31, 2015.

The Bureau added interest and penalty to the sales tax and 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 February 28, 2018, 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 December 1, 2017, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

IT IS ORDERED that Petitioner pay the following tax, penalty, and interest:

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$83,596	\$4,180	\$6,096	\$93,872
		Paid May 24, 2017:	(9,896)
		TOTAL DUE:	<u>\$83,976</u>

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

An explanation of Petitioner's right to appeal this decision is included with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2018.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2018 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.

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