

Cite as Det. No. 04-0145R, 24 WTD 400 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 04-0145R
...)	
)	Registration No. . . .
)	Document No. . . .
)	TDO No. . . .
)	Docket No. . . .

RULE 178; RCW 82.04.050; ETA 482.12.178: USE TAX – PURCHASE FOR RESALE (LEASING) -- REGULAR COURSE OF BUSINESS. A corporation formed to purchase and lease an aircraft, which leases the aircraft to another business owned by an officer of the corporation, will owe neither retail sales tax on the purchase, nor use tax on the use, if the evidence establishes that the lessor is actually and regularly engaged in the business of leasing such articles, and the lease to the officer’s business is not illusory.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Prusia, A.L.J. – A corporation formed to purchase and lease a helicopter, which initially leased the helicopter to a third party but later leased it to a business owned by the corporation’s president, requests reconsideration of Det. No. 04-0145, which sustained an assessment of use tax on the value of the helicopter and repairs. Additional facts provided on reconsideration establish that the taxpayer at all times held the helicopter solely for leasing in the regular course of business. The petition is granted, and the assessment is cancelled.¹

ISSUE

Did the taxpayer hold the helicopter solely for leasing in the regular course of business, or did it discontinue leasing as a business activity and allow its president to put the helicopter to his own use?

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

Taxpayer, . . . , seeks reconsideration of Det. No. 04-0145, which sustained the assessment of use tax on the use of a helicopter, which Taxpayer contended it purchased and held solely for the purpose of leasing in the regular course of business. Taxpayer asserts there were mistakes of fact and law in Det. No. 04-0145 that necessitate reconsideration. Taxpayer further asserts there are additional facts that were not presented because the administrative law judge failed to alert Taxpayer that certain issues the Department had not previously focused on would be central to the decision on appeal. Facts set out in Det. No. 04-0145 are repeated and supplemented here only to the extent necessary for this decision.

Taxpayer is a Washington corporation formed [in] . . . , 2001. Its sole owner is [Owner]. Its registered agent and president is [Husband], the husband of [Owner]. [Husband] is a business consultant, operating [Company] in [Washington].

[Husband] set up Taxpayer as a business for his wife, to take advantage of an opportunity to purchase and lease-back a small training helicopter. [Four months after its formation], Taxpayer purchased a . . . helicopter, . . . , from [Seller], in . . . , Washington, pursuant to an agreement that [Seller] would lease back the helicopter for use in [Seller's] flight school. The purchase price was \$ Taxpayer did not pay Washington retail sales tax on the purchase.

[One day after the purchase], Taxpayer and [Seller] entered into a formal lease agreement. The lease agreement was a "dry lease" at the rate of \$[X] per hour plus retail sales tax. A "dry lease" is one in which the lessee is responsible for maintenance and fuel. \$[X] per hour was the usual "dry lease" rate for a . . . helicopter at the time.² [Seller] also was responsible for providing a hangar and insuring the helicopter.

[Several weeks after commencement of the lease], a . . . problem developed in the helicopter. A certified mechanic determined that the problem was in the . . . system. . . . The exact repairs needed were unknown and could not be determined without dismantling the . . . system. Dismantling or replacing the system could have cost up to [30% of the purchase price of the helicopter], and Taxpayer and [Seller] chose to keep the helicopter in operation with periodic [maintenance] while they tried to pinpoint the problem.³

[Two months later], due to business reversals, [Seller] decided to close its flight school and concentrate on other business. . . [Seller] ceased doing business at the . . . flight school, and notified Taxpayer that Taxpayer could take possession of the helicopter, or lease it to another party.

² Documentation of the market rate for a dry lease of a [helicopter], and the market rate for a lease where the lessor is responsible for maintenance and fuel, is summarized in Det. No. 04-0145.

³ Documentation that the helicopter had a . . . problem of undiagnosed cause is summarized in Det. No. 04-0145.

The unresolved . . . problem effectively prevented immediately leasing the helicopter to a stranger. [Several weeks later], Taxpayer entered into an aircraft lease agreement with [Husband's] company. . . . The [Company] lease was identical to the [Seller's] lease, except that it provided for rent at the rate of \$[0.7X] per hour, rather than \$[X] per hour, and [Company] agreed to be responsible for unattended maintenance problems. The . . . , minutes of Taxpayer's board of directors state that the reduction in rent was in consideration of [Company's] agreement to be responsible for the maintenance problems which would likely require costly work on the . . . system, and would remain at that rate for eighteen months or until both parties agreed that the abnormal costs had been recovered by [Company] from the reduced rent, and would then increase to \$[1.1X] per hour. The minutes also state that if a lease with another flight school or a sale at fair value could be arranged, the parties agreed to terminate the lease.

Taxpayer took possession of the helicopter and moved it from the . . . airport to a lot next to the [Owner and Husband's] home, where a . . . structure had been erected as a hangar.

[Husband] used the helicopter to transport clients to various locations on [Company] business-related matters. He investigated options for determining and remedying the cause of the continuing . . . problem.

On September 11, 2001, terrorists crashed airplanes into the World Trade Center in New York City. The attack had a significant adverse effect on general aviation. The leasing market for small aircraft such as the [helicopter] was severely depressed.⁴

During the next thirteen months, [Company] continued to lease the helicopter. Taxpayer had made a continuing offer to a local flight school to lease the aircraft, but received no offer. Taxpayer had the certified mechanic attempt various repairs to the . . . system . . . , but did not seek an immediate cure for the . . . problem. [Approximately one year later], the [helicopter was repaired], and . . . certified as complete [two months later]. The . . . problem cost [less than \$3,000] to correct, and [Company] paid for the repairs.⁵

After the repairs were certified as complete, Taxpayer offered the helicopter for sale to [Helicopter School], but received an offer of only [2/3 its original purchase price], which Taxpayer rejected as insufficient. Taxpayer stated, in its original appeal, that it made other efforts to lease the helicopter, but provided no evidence of its efforts.

⁴ [Husband] so testified, and news reports in the public media support his testimony. *See, e.g.,* http://www.ainonline.com/Publications/HAI/HAI_2003/HAI_03_d22003outlookpg8.html (the president of Schweizer Aircraft is quoted as follows: "The training market had a terrible time after September 11," said Schweizer. "But now we're seeing some positive signs that there has been an upturn in the market. We're expecting to produce approximately 45 helicopters this year, which is a higher annual count than we've had for years."); http://www.aviationtoday.com/cgi/rw/show_mag.cgi?pub=rw&mon=0702&file=0702interview.htm.

⁵ Documentation of the repairs and payment are summarized in Det. No. 04-0145. . . .

[Two months later], Taxpayer entered into a new dry lease agreement with [Company] which provided for rental at the rate of \$[1.1X] per hour plus retail sales tax.

Taxpayer submitted copies its of quarterly excise tax returns for the last half of 2001, all of 2002, and the first three quarters of 2003, showing it reported and paid retailing B&O tax and retail sales tax. As evidence that the revenues reported related to rental of the helicopter, and were accurate and properly documented, it submitted copies of canceled checks from [Company] to Taxpayer paid during the last half of 2001 and the first quarter of 2002, and copies of Taxpayer's bank deposit slips showing the deposit of those checks. Taxpayer provided copies of corporate minutes and other corporate documents that were well organized and showed it observed corporate formalities.^[6]

DOR's Compliance Division began an investigation of Taxpayer's activities in June 2002. On April 16, 2004, the Compliance Division issued the above-numbered assessment against Taxpayer, in the amount of \$ The assessment was for deferred sales tax/use tax on the helicopter on a value of [Taxpayer's purchase price for the helicopter], use tax on \$. . . in repairs, a 20% late payment penalty, and interest. The Compliance Division asserted that Taxpayer had acquired the helicopter for the personal use of [Husband] rather than for leasing in the regular course of business. It contended that Taxpayer's lease to [Seller] was questionable, the lease to [Company] had no economic substance, the relationship between Taxpayer and [Company] was not arms-length, and both leases should be disregarded.

Det. No. 04-0145 found that Taxpayer had purchased the helicopter for leasing in the regular course of business, but had discontinued engaging in the business of leasing the helicopter in the regular course of business after [Seller] defaulted on its lease. The latter finding was based on a combination of facts. Leasing only to [Company], even at market rates, did not reflect economic reality; Taxpayer admitted there was no possibility it could earn a profit if it only leased to [Company]. [Husband] had testified that leasing to [Company] was a mere stopgap to generate some revenue and maintain the helicopter, and stated he had made unsuccessful efforts to lease or sell the aircraft, but Taxpayer had presented no corroborating evidence, and the slowness in diagnosing and concluding the repair of the . . . system were inconsistent with the assertion that the lease to [Company] was intended to be a mere stopgap. Det. No. 04-0145 sustained the assessment of use tax on the value of the helicopter on the date it was put to taxable use, [the date Taxpayer entered the lease with Company], but found that the original purchase price did not represent the true value of the helicopter at that time, and remanded the file to the Compliance Division to allow Taxpayer an opportunity to establish the retail selling price on that date, [at the place of sale], of similar products of like quality and character. Det. No. 04-0145 sustained the assessment of use tax on the value of repairs performed . . . after July 1, 2002, the effective date of RCW 82.12.010(3)(b). Det. No. 04-0145 granted Taxpayer's request for a credit for retail sales tax remitted on lease payments by [Company].

^[6] The ALJ also reviewed the flight log, which did not contradict Taxpayer's claim that the helicopter was used solely for the purpose of leasing it to [Seller] and [Company].]

On reconsideration, Taxpayer provided additional facts regarding [Company's] use of the helicopter, the length of time taken to diagnose and repair the helicopter, and efforts to lease or sell the helicopter. [Husband] provided evidence that the [helicopter] was a two-person helicopter used principally for training, testified that [Company] really needed a larger aircraft for hauling clients, and said [Company] continued leasing it only because no other lease or sale opportunity materialized. He testified that because of the depressed lease and sales market, there never was a reason to speed up the pace of diagnosis and repair, so Taxpayer continued the cheaper incremental approach to fixing the vibration problem. Taxpayer provided a statement from [a Washington Helicopter Co.], that Taxpayer contacted [Washington Helicopter Co.] in both 2002 and 2003 about leasing the [helicopter], but during that period [Washington Helicopter Co.] had no need for additional . . . helicopters. Taxpayer provided a statement from [Agent], an agent who buys and sells used . . . helicopters, that during the second half of 2001 and during 2002 and 2003, on behalf of Taxpayer, [Agent] made numerous efforts to place the helicopter into a lease or sale, but the market after 9/11 was extremely weak, and he was unable to locate a suitable lease or sale. Taxpayer provided the statement of the former owner of [Seller] that, at the request of Taxpayer, he located a potential sale of the helicopter near the end of 2002, to [Helicopter School], but the offer was only [2/3 its original purchase price], which was at least \$20,000 below the value of the helicopter, and Taxpayer did not accept the offer.

On reconsideration, Taxpayer also provided information to correct misstatements in Det. No. 04-0145 regarding the value of repairs to the helicopter. That additional information is not relevant to our decision.

In February 2004, Taxpayer sold the helicopter to [a third party], for a price of [slightly less than its original price].

ANALYSIS

Washington has both a retail sales tax and a use tax. Retail sales tax is an excise tax imposed on each retail sale in this state, to be paid by the buyer to the seller. RCW 82.08.020; RCW 82.08.050. The use tax complements the retail sales tax by imposing a tax, generally equal in amount to the retail sales tax, on the use of items of tangible personal property in this state, as a consumer, where the retail sales tax has not been paid. WAC 458-20-178 (Rule 178).

A sale to a person who presents a resale certificate and “[p]urchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person” is expressly excepted from the definition of “retail sale.” RCW 82.04.050(1)(a). The term “retail sale” includes the renting or leasing of tangible personal property to consumers. RCW 82.04.050(4). Thus, the retail sales tax does not apply upon sales of tangible personal property to

persons who purchase the same solely for the purpose of renting or leasing such property without operators. WAC 458-20-211(6)(a) (Rule 211(6)(a)).⁷

In order to qualify for the purchase for resale exception, the purchaser must actually be in the business of reselling or leasing such articles. In Excise Tax Advisory 482.12.178 (ETA 482), DOR explained the meaning of “resale . . . in the regular course of business,” as follows:

The Department has held that to determine that a sale is for resale, it must be determined that the purchaser is actually and regularly engaged in selling the type of property purchased, is registered with the Department of Revenue and reporting the appropriate taxes, and that at the time of the transaction the purchaser intended the sale to be for resale without intervening use by the purchaser.

In order to qualify for the purchase for resale exception, a taxpayer must also meet the “without intervening use” condition. Intervening use occurs when an item held for resale is used by the business as a consumer before the item is sold, or when an item held for lease is also used by the lessor for personal purposes. *See* Excise Tax Advisory 481.12.178 (ETA 481);⁸ WAC 458-20-132(5); Excise Tax Advisory Excise Tax Advisory 54.12.211 (ETA 54). Use tax also applies when an item is withdrawn from the inventory of items held for resale (or leasing) and put to personal use by the taxpayer. The use tax is due upon the removal of the item from inventory. *See* Det. No. 91-044, 10 WTD 395 (1990).

Det. No. 04-0145 found that Taxpayer purchased the helicopter for the purpose of leasing in the regular course of business, but it also found that Taxpayer had discontinued or suspended leasing the aircraft in the regular course of business after [Seller] defaulted on its lease. It held that use beginning [the date Taxpayer entered the lease with Company], was personal use by the president, and taxable.

Based upon the additional evidence provided on reconsideration, we find that Taxpayer continued to hold the helicopter for lease in the regular course of business on and after [the date Taxpayer entered the lease with Company]. We find the lease to [Company] was not illusory. Taxpayer did not give [Company] preferential treatment, and received and reported regular lease payments from [Company]. Taxpayer made bona fide efforts to place the helicopter into other leases or a sale. We also take notice of the fact that the events in question occurred in a highly unusual context, the

⁷ Although the lessor does not owe tax on its purchase, persons who lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due. Rule 211.

⁸ ETA 481 explains:

A person who purchases an article of tangible personal property for resale or lease without intervening use need not pay the sales or use tax. However, no such exemption exists for a purchaser who both leases the article and uses it for personal purposes. Therefore, the Department holds the sales or use tax to be applicable to the purchase or use of any item of tangible personal property used by the purchaser for both leasing and personal purposes. The measure of the tax is the entire purchase price, or value of the article used. The tax is not applied pro rata on the basis of the comparative percentages of personal and leasing use.

depressed civil aviation market caused by the terrorist attack on September 11, 2001. The context adds credibility to [Husband's] testimony that Taxpayer continued, without success, to seek lease arrangements with third persons.

On reconsideration, we conclude there was no taxable use of the helicopter. Because the repairs to the helicopter were to an aircraft devoted exclusively to leasing purposes, the repairs also were for resale and not subject to sales tax or use tax. WAC 458-20-173 (Rule 173). The assessment therefore should be cancelled.

We do not reach issues raised and argued on reconsideration that relate to the measure of use tax.

We reverse Det. No. 04-0145's allowance of a credit for retail sales tax remitted on lease payments by [Company]. That tax was properly collected and remitted, based on our findings and conclusions on reconsideration.

DECISION AND DISPOSITION

Taxpayer's petition for reconsideration is granted.

Dated this 8th day of April, 2005.