Cite as Det. No. 94-226, 15 WTD 65 (1995).

BEFORE THE INTERPRETATIONS AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 94-226
. . .	)	Registration No. . . .
	)	Warrant No. . . .

[1] RULE 175, RULE 178; RCW 82.08.0261, RCW 82.08.0262, RCW 82.12.0254: USE TAX -- EXEMPTIONS -- PRIMARY USE -- AIRCRAFT -- INTERSTATE COMMERCE. Aircraft primarily used by a private carrier to conduct interstate commerce by transporting property therein for hire are exempt from use tax.

[2] RULE 211; RCW 82.12.020, RCW 82.04.190; ETB 321: RETAIL SALES TAX -- USE TAX -- AIRCRAFT PURCHASED FOR LEASE -- FLIGHT INSTRUCTION: In general, aircraft purchased by a taxpayer for providing flight instruction services are subject to use tax. However, a different result may occur where a taxpayer separately charges student pilots retail sales tax for lease of aircraft pursuant to lease agreements under which the student pilots assume possession and control of the aircraft. Under such circumstances, the aircraft was purchased for resale, and it is not subject to use tax so long as the aircraft is not put to intervening, non-exempt use.

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.

NATURE OF ACTION:

Company which provides charter services, flight training services, and aircraft maintenance services protests assessment

of use tax on its aircraft and seeks a credit for various over payments of taxes not identified in the audit.[1]

FACTS:

Mahan, A.L.J. -- The taxpayer provides air taxi services, charter flight services, flight training services, and aircraft maintenance and fueling services. The Department of Revenue (Department) audited the taxpayer. The Department issued an assessment, including interest. A warrant was later filed for the unpaid balance, additional interest, and a warrant penalty.

Under Schedule II, the Department assessed use tax on certain aircraft purchased by the taxpayer which are used for flight instruction as well as for charter. Under Schedule III, the Department assessed use tax on fuel consumed during flight instructions.

In its petition, the taxpayer argued that, because the aircraft on which it was assessed use tax are used extensively for bare charters, it should either not be assessed use tax on those planes or the tax should be pro-rated based on use. It also states that it erred in identifying two aircraft as being used for flight instruction when they are used solely for hauling freight or passengers.[2] The taxpayer further stated that another operator at another air field is only assessed use tax on one aircraft per year and it should receive the same treatment.

The Audit Division supplied the taxpayer with a copy of Excise Tax Bulletin 321.16.179.224 (ETB 321), which addresses the taxation of air taxi services, charter flights, and student training fees. Based on the information in this ETB, the taxpayer now contends that it should receive certain credits for overpayment of taxes not identified during the audit. Included in these claims are: service business and occupation (B&O) tax paid on passenger charter revenue, sales tax on fuel purchased away from base for hauling freight interstate, the payment of service B&O tax rather than public utility tax on hauling freight intrastate, and certain unclaimed bad debt deductions. In response, the Audit Division recognizes that some or all of these claims may be valid, depending on the taxpayer's books and records. Accordingly, the issues raised by this claim to a

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

[2]The Audit Division responded that, subject to a further review of records, it was the Department's understanding that those aircraft were purchased and used by the taxpayer prior to it engaging in an air freight business.

credit are remanded to the Audit Division without further discussion.

At the hearing the taxpayer explained that persons taking flight instruction enter into a written lease agreement for the plane and are charged on a per hour basis for the use of the airplane. This per hour charge includes the cost of fuel, which is not separately stated. Retail sales tax is added to the total cost. The student pilot can then supply his or her own instructor, who has to be approved by the taxpayer, or select one of the instructors employed by the taxpayer. Should the student pilot select one of the taxpayer's instructors, the taxpayer separately charges for the instructor's time. No retail sales tax is added to this charge; rather, the taxpayer pays service B&O tax on that income.

The taxpayer recognizes that, although the plane may be operated by the student pilot, the instructor is ultimately responsible for the safety of the plane and its passengers. Under the terms of the lease agreement, the student pilot is responsible for insurance and all damages to the aircraft.

As related by the taxpayer, its freight business in large part consists of parcel shipments. The cargo is brought into a Washington airport from out-of-state, and the taxpayer then delivers it to cities in Washington.

At the hearing, the taxpayer took exception with Schedule II of the audit in that the Department received retail sales tax from the rental of the planes to student pilots. The taxpayer contends that the Department should not also assess use tax on the purchase of the planes. The taxpayer also took exception with Schedule II whereby the Department assessed use tax on fuel costs, when sales tax had already been collected from the student pilots and remitted to the state.

ISSUES:

1. Whether the taxpayer is entitled to pro-rate the use tax based on an aircraft's use for flight instruction, taxi service, or for bare charter.

2. Whether the two aircraft identified as being used solely for hauling passengers or freight in interstate commerce are subject to use tax.

4. Whether the taxpayer must pay use tax on airplanes and fuel used by student pilots where the students lease the planes and pay sales tax on the lease payments, which includes fuel costs.

DISCUSSION:

RCW 82.12.020 provides that use tax shall be imposed where retail sales tax was due but not paid. It reads in pertinent part:

> There is hereby levied and there shall be collected from every person in this state a tax or excise for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail, or acquired by lease, . . .

See also WAC 458-20-178 (Rule 178).

In general, there is no provision within the applicable statutes or rules to pro-rate the use tax should an item be used by a taxpayer as a consumer.[3] In order to avoid paying use tax, the taxpayer has the burden to establish either that it comes under an exemption or that it did not use the planes as a consumer. In this case, the taxpayer must establish the right to rely on an exemption for aircraft primarily used in interstate commerce, or that the planes that were purchased for lease to others without any intervening use by the taxpayer. Each potential basis for not paying the use tax will be discussed in turn below.

a. Primarily used in interstate commerce.

[1] The Legislature has chosen to exempt private carriers from sales tax if the carrier business is "conducting interstate commerce by transporting therein or therewith property or persons for hire."

RCW 82.08.0262 states in pertinent part:

> The tax levied by RCW 82.08.020 [retail sales tax] shall not apply to sales of airplanes, . . . for use in conducting interstate or foreign commerce by transporting therein or

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[3]The use tax obligation has been modified with respect to aircraft dealers. See ETB 319.12.178. In accordance with that ETB, a dealer which uses aircraft held for sale for charter flights may have the use tax obligation modified, under the theory that the sales tax will eventually be paid by the purchaser of the plane. This is apparently the source of the taxpayer's concern that another flight service is only charged use tax on one airplane a year. The taxpayer, however, is not a registered dealer and this modification of the use tax is not available to it.

> therewith property and persons for hire . . . ; also sales of tangible personal property which becomes a component part of such airplanes, . . .

RCW 82.08.0261 further provides:

> The tax levied by RCW 82.08.020 shall not apply to sales of tangible personal property (other than the type referred to in RCW 82.08.0262) for use by the purchaser in connection with the business of operating as a private or common carrier by air, rail, or water in interstate or foreign commerce: Provided, That any actual use of such property in this state shall, at the time of such actual use, be subject to the tax imposed by chapter 82.12 RCW [use tax].

RCW 82.12.0254 further provides that:

> The provisions of this chapter [use tax] shall not apply in respect to the use of any airplane, . . . used primarily in conducting interstate or foreign commerce by transporting therein or therewith property . . . , and in respect to use of tangible personal property which becomes a component part of any such airplane, . . .

WAC 458-20-175 (Rule 175) is the administrative rule implementing the statutory exemptions from retail sales tax, RCW 82.08.0261 and 0262, as well the exemption from use tax, RCW 82.12.0254. It provides:

> By reason of specific exemptions contained in RCW 82.08.0261 and 82.08.0262 the retail sales tax does not apply upon the following sales:
>
> (1) Sales of airplanes, . . . for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire;
>
> (2) Sales of tangible personal property which becomes a component part of such carrier property in the course of constructing, repairing, cleaning, altering or improving the same; . . .

Regarding use tax, Rule 175 provides: "The use tax does not apply upon the use of airplanes, . . . including component parts thereof, which are used primarily in conducting such businesses."

Rule 178 further provides in pertinent part:

> (7) Exemptions. Persons who purchase, produce, manufacture, or acquire by lease or gift tangible personal property for their own use or consumption in this state, are liable for the payment of the use tax, except as to the

> following uses which are exempt under RCW 82.12.0251 through 82.12.034 of the law: . . .
>
> (f) In respect to the use of any airplane, locomotive, railroad car, or water craft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or used primarily in commercial deep sea fishing operations outside the territorial waters of the state, ...

(Emphasis added.) Thus, use tax is not imposed if an aircraft, which is used for both intrastate and interstate commerce, is used more than 50% of the time to transport property or persons for hire in interstate commerce.[4] Therefore, if the taxpayer primarily used the aircraft and/or chartered it to someone else to conduct interstate commerce by transporting therein property or persons for hire, the aircraft is exempt from use tax.[5]

We remand to the Audit Division to determine whether the aircraft was primarily used as required under the statutory exemptions. If, however, the taxpayer put the aircraft to intervening, nonexempt use for periods prior to using it in interstate transportation, the exemption would not be available.

b. Aircraft used for charter or lease by others.

[2] In general, a person who purchases or leases an article of tangible personal property for resale or lease in the regular course of business without intervening use need not pay sales or use tax. However, no such exemption exists for a taxpayer who also uses the item in conducting its own business. Use by a taxpayer of tangible personal property ordinarily subjects the taxpayer to liability for use tax measured by the full purchase or rental price of the property. ETB 481.12.178; See, e.g., Det.

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[4]Leasing an airplane to a party who transports property or persons in interstate or foreign commerce does not qualify for the use tax exemption created by RCW 82.12.0254; the statute requires that the transportation of the property or persons, rather than the airplane, be for hire. Browning v. Department of Rev., 47 Wn. App. 55, 733 P.2d 594 (1987).

[5]We note that there is no boundary crossing requirement per se for aircraft under the exemption. See, United Parcel Service v. Department of Revenue, 102 Wn.2d 355, 362, 687 P.2d 186 (1986); Det. No. 91-323ER, 13 WTD 38 (1993); ETB 250.16.179.193.

No. 90-397, 10 WTD 341 (1990). Accordingly, the taxpayer here would be entitled to the exemption only if it leased or chartered the aircraft to its customers and did not subject the aircraft to any intervening use.

In this regard, ETB 321.16.170.224 (ETB 321) generally describes the tax liability of companies which provide air taxi services, charter flights, and student training services. With respect to training, the ETB provides:

> The following is a list of activities with the tax classification identified which applies to the activity. This list is intended to be representative of activities performed with aircraft, but should not be considered as all inclusive.
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> . . .
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> Service and Other Activities (B&O Tax):
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> . . .
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> 9. Student instruction and training flights. This includes solo flight training where the pilot is a registered student in a bona fide training program, is at all times flying in a regulated pattern, and is at all times under the control of the instructor. A charge to a student for the use of an airplane for a solo flight which does not meet the above conditions is taxable under retailing B&O tax and retail sales tax liability as the bare rental of an aircraft.

This rule addresses the manner in which flight instruction is commonly structured. See also Excise Tax Bulletin 54.12.211 (ETB 54). As ETB 321 states, it is not all inclusive. We do not read it or ETB 54 as precluding a valid lease of aircraft to student pilots, particularly in light of other rules and court decisions. In general, a lease, rental, or bailment of tangible property requires the relinquishment of possession and control over the item by one party and the acceptance of such possession and control by the other party. Duncan Crane v. Department of Rev., 44 Wn. App. 684, 689, 723 P.2d 480 (1986); Collins v. Boeing Co., 4 Wn. App. 705, 711, 483 P.2d 1282 (1971). Whether possession and control has in fact been transferred is a question of fact. As stated in Collins:

> Whether there is a change or acceptance of possession depends on whether there is a change or acceptance of actual or potential control in fact over the subject matter . . . . In determining whether control exists, it is relevant to consider the subject matter's amenability to control, steps

> taken to effect control, the existence of power over the subject matter, the existence of power to exclude others from control, and the intention with which the acts in relation to the subject matter are performed.

More specific to the exception from retail tax for the lease, rental, or bailment of personal property, WAC 458-20-211(3) (Rule 211) provides:

> A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. Where the owner of the equipment or the owner's employees or agents maintain dominion and control over the personal property and actually operate it, the owner has not generally relinquished sufficient control over the property to give rise to a true lease, rental, or bailment of the property.

In this case, the taxpayer has structured its leases with student pilots whereby they receive possession of the aircraft and are responsible for insurance and any damage to the aircraft. Although the instructor in non-solo flights may assert certain control over the aircraft, it is the student who generally operates the aircraft. The taxpayer has treated the arrangement with the student pilots as a lease of the aircraft by charging retail sales tax on the use of the aircraft. The student also selects his or her own instructor. The student is then separately charged for instructions by the taxpayer should the student use one of the taxpayer's instructors.

Based on the evidence before us, it appears that the use of the aircraft is pursuant to a true lease, separate from the flight instruction services. Should the taxpayer's records confirm that all of the training flights are structured in this manner, the aircraft used for flight instructions are not subject to use tax, provided that there is no other intervening, non-exempt use of the aircraft. Rather, the taxpayer should, as it has done, collect retail sales tax on the aircraft rental payments and pay retailing B&O tax on that portion of its gross receipts.

With respect to fuel costs, it appears that use tax was assessed on the fuel used in flight instruction on the theory that the taxpayer was the consumer of the fuel in operating its business. To the extent that the taxpayer can present sufficient records to demonstrate that the aircraft lessees paid tax on the fuel, the taxpayer would not be liable for use tax on those fuel payments.

DECISION AND DISPOSITION:

This matter is remanded to the Audit Division for verification and adjustment in accordance with this determination. The taxpayer shall have thirty days from the date of this determination to contact the Audit Division and to provide it with documentation to substantiate the taxpayer's claim that the subject aircraft were exempt from use tax, either because they were primarily used for interstate commerce during all relevant periods, as discussed above, or the aircraft were validly leased to student pilots without any intervening use. At that time, the taxpayer must also submit documents to support its claim for credits not addressed in the original assessment and with respect to its claim that the student pilots paid tax on the fuel costs. Should the taxpayer fail to provide adequate documentation in a timely manner, the assessment shall be affirmed in full.

DATED this 27th day of October, 1994.