Cite as Det. No. 04-0075, 25 WTD 95 (2006)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of Tax of	)	D E T E R M I N A T I O N
	)	No. 04-0075
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .

[1] RULE 179: PUBLIC UTILITY TAX – AIRFREIGHT. Income derived from the carriage of passengers or mail in air commerce (federally regulated airspace, whether an interstate or intrastate flight), is exempt from public utility tax. Income derived from the interstate carriage of passengers, mail, or freight is exempt from public utility tax. Income derived from providing purely intrastate freight hauling services is subject to the public utility tax, even if the intrastate haul occurs in federally regulated airspace.

[2] RULE 178: USE TAX –AIRCRAFT –PURCHASES OF AIRCRAFT AND REPAIRS. Exemption from the use tax requires that the taxpayer document that the aircraft was "used primarily in conducting interstate or foreign commerce by transporting property or persons."

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.

Lewis, A.L.J. – Taxpayer operates an aircargo service that does business both within and without Washington. Taxpayer appeals the Department of Revenue's ("Department") assessment of Other Public Utility Tax on unreported revenues earned from carrying aircargo entirely within Washington and the use tax assessed on the purchase of aircraft and repairs used to transport freight in Washington. Taxpayer argues that Federal law precludes the taxation of revenues derived from hauling freight in federally regulated airspace. Similarly, Taxpayer argues that because the aircraft is used to transport goods in interstate commerce the use tax was

assessed in error. We disagree. While Federal law prevents a state from taxing revenues derived from hauling people or mail in federally regulated airspace or across state lines, there is no such prohibition against taxing income derived from hauling air cargo intrastate. Similarly, the exemption for use tax on carrier property used to transport goods in interstate commerce is only applicable where the taxpayer documents the aircraft are used primarily (more than 50% of the time) in interstate commerce.[1]

ISSUES:

1. Is Washington's Other Public Service Public Utility tax applicable to income derived from hauling aircargo from point-to-point within Washington?

2. Did the Audit Division err in assessing use tax on Taxpayer's purchase or lease of 1) aircraft; 2) aircraft parts; and 3) repair services?

FINDINGS OF FACT:

Lewis, A.L.J. – Taxpayer is a certified air carrier. Its primary customers are major commercial banks, independent financial institutions, and priority freight forwarding companies. An example of Taxpayer's service is the transportation of checks and other documents between small community branch banks and computer processing centers in large cities. Taxpayer operates from twelve major hubs, including Seattle.

The Department's Audit Division audited Taxpayer's business records for the period January 1, 1999 through December 31, 2001. . . . the Department issued a $. . . assessment. The Audit Division assessed Other Public Service Public Utility tax on unreported income received from the pick-up and delivery of freight on flights that operated entirely in Washington. The determination of which income was totally intrastate was based on the Audit Division's review of documents . . . which tracked Taxpayer's revenues by date, customer number, document number, and flight description. The Audit Division also assessed use tax/deferred sales tax on Taxpayer's purchase or lease of 1) aircraft; 2) aircraft parts; and 3) repair services reasoning that the use of the aircraft did not qualify for the use/deferred sales tax exemptions allowed for aircraft used to transport people or property across state lines.

Taxpayer paid the assessment and . . . filed a petition requesting a refund of tax paid. Taxpayer maintained that its activities in Washington constitute interstate commerce and are thus shielded from Washington state tax by constitutional and federal law prohibitions against taxing revenues derived from providing air transportation in federally regulated airspace or interstate or foreign commerce. Similarly, Taxpayer maintains that the same constitutional prohibitions shield from Washington use tax/deferred sales tax its expenditures for the purchase, lease, repair, and overhaul of aircraft.

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

ANALYSIS:

[1] Federal law precludes states from taxing revenues derived from providing air transportation in Federally regulated airspace or interstate or foreign commerce. Specifically, 49 U.S.C. § 40116(b) states:

> [A] State or political subdivision of a State may not levy or collect a tax, fee, head charge, or other charge on --
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> (1) an individual traveling in air commerce;
> (2) the transportation of an individual traveling in air commerce
> (3) the sale of air transportation; or
> (4) the gross receipts from that air commerce or transportation.

49 U.S. C. §40102(a)(3) defines "air commerce" to mean:

> foreign air commerce, interstate air commerce, the transportation of mail by aircraft, the operation of aircraft within the limits of a Federal airway, or the operation of aircraft that directly affects, or may endanger safety in, foreign or interstate air commerce.

"Interstate air commerce" means "the transportation of passengers or property by aircraft for compensation, the transportation of mail by aircraft, or the operation of aircraft in furthering a business or vocation" between states, possessions of the U.S., or the District of Columbia. 49 U.S.C. §40102(24).[2]

The U.S. Supreme Court, in *Aloha Airlines v. Director of Taxation of Hawaii*, 464 U.S. 7 (1983), affirmed that a state may not impose a gross receipts tax on the revenues an airline receives from providing air transportation or the carriage of persons in air commerce.[3] The Court stated that laws passed by Congress were intended to prevent states from levying taxes that would burden interstate air transportation . . . . Specifically, the Court stated:

> Section 1513(a) expressly pre-empts gross receipts taxes on the sale of air transportation or the carriage of persons traveling in air commerce, and Haw. Rev. Stat. §239-6 is a state

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[2] 49 U.S.C. also includes the following definitions:

49 U.S.C. §40102(a)(5) defines "air transportation":

> Air transportation means interstate, overseas, or foreign air transportation or the transportation of mail by aircraft.

49 U.S.C. §40102(a)(25) defines "interstate air transportation" as:

> the carriage by aircraft of persons or property as a common carrier for compensation or hire or the carriage of mail by aircraft in commerce between . . . a place in any State of the United States or the District of Columbia and any place in any other State of the United States or the District of Columbia; or between places in the same State of the United States through the airspace over any place outside thereof . . . .

[3] Aloha Airlines is a commercial airline that was carrying passengers, freight, and mail among the islands of Hawaii.

> tax on the gross receipts of airlines selling air transpiration and carrying persons traveling in air commerce.

Id. at 11. The Court also stated:

> First, when a federal statue unambiguously forbids the States to impose a particular kind of tax on an industry affecting interstate commerce, courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is pre-empted.

Id. at 12. Finally, the Court concluded:

> § 1513(a) proscribes the imposition of state and local taxes on gross receipts derived from air transportation or the carriage of persons in air commerce.

Id. at 14-15.

The Department took note of the Court's decision in *Aloha Airlines* when it issued Det. No. 99-215, 19 WTD 817 (2000), which stated:

> we find the taxpayers' argument that the federal statute pre-empts imposition of the tax to be unpersuasive. We note that the transportation that was taxed in this case was transportation of cargo (not passengers or mail) between Washington cities. As such, it did not meet the definitions of interstate air commerce or air transportation set forth in federal statutes. Specifically, the travel was not between "a place in any State of the United States or the District of Columbia and any place in any other State of the United States or the District of Columbia; or between places in the same State of the United States through airspace over any place outside thereof." *See* 49 U.S.C. section 40102(a)(25). As noted in *Aloha Airlines*, "There is no prohibition in federal law from taxing the intrastate transportation of freight with the exception of U.S. mail." As such, the taxpayer's petition is denied with respect to this issue.

Following the issuance of Det. No. 99-215, the Department issued Excise Tax Advisory 2006.16.179 ("ETA 2006") to explain the taxability of revenues derived from air transportation.[4] ETA 2006 states in part:

> Federal law prohibits states from levying a tax on: "(1) an individual traveling in air commerce; (2) the transportation of an individual traveling in air commerce; (3) the sale of air transportation; or (4) the gross receipts from that air commerce or transportation." 49 U.S.C. § 40116(b). The term "air transportation" means interstate or foreign air transportation of passengers or property as a common carrier for compensation, or the transportation of U.S. or foreign transit mail by aircraft. *See* 49 U.S.C. § 40102(a)(5),

[4] Issued on September 6, 2001.

> (23), (25), and (29). The term "air commerce" includes, among other things, "the operation of aircraft within the limits of a Federal airway, or the operation of aircraft that directly affects, or may endanger safety in, foreign or interstate air commerce." 49 U.S.C. § 40102(a)(3).
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> In *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7 (1983), the U.S. Supreme Court held that 49 U.S.C. § 1513(a) (presently codified in substantially similar form at 49 U.S.C. § 40116(b)) prohibited the imposition of state and local gross receipts taxes on the sale of air transportation or the carriage of persons traveling in air commerce.

The ETA concluded, based on its analysis of federal law and the Court's ruling in *Aloha Airlines* that the federal law prohibits the Department from taxing the following activities:

- Transportation of passengers to intrastate, interstate, or foreign destinations including both charter flights and regularly scheduled flights.
- Hauling property to interstate or foreign destinations.
- Hauling U.S. or foreign transit mail.

Similarly, the ETA concluded that the following activities were subject to taxation:

- Intrastate hauling of property, except U.S. or foreign transit mail.
- Intrastate non-passenger air ambulance transportation of property such as human organs, medical supplies or equipment.

Thus, the ETA acknowledges that, while the Department is prevented from taxing income derived from transporting persons or mail in interstate commerce or in a federal airway located in Washington, there is no prohibition from taxing income derived from the intrastate hauling of property, which is not U.S. mail.

The ETA's conclusion is consistent with footnote 11 in *Aloha Airlines* at 15, which stated:

> *Arizona Dept. of Revenue v. Cochise Airlines*, 128 Ariz. 432, 626 P. 2d 596 (Ariz. Ct. App. 1980) (§ 1513(a) preempts state gross receipts taxes on the carriage of passengers, but not freight, in air commerce) . . . .

In conclusion, income derived from the carriage of passengers or mail in air commerce (federally regulated airspace, whether an interstate or intrastate flight), is exempt from the public utility tax. Similarly, income derived from the interstate carriage of passengers, mail, or freight is exempt from the public utility tax. In contrast, income derived from providing purely intrastate freight hauling services is subject to the public utility tax, even if the intrastate haul occurs in federally regulated airspace. The income taxed was derived from the intrastate hauling of non-mail freight

in Washington.[5] Thus, we conclude the Audit Division was correct to tax the income. Accordingly, the public utility tax assessed on the intrastate hauling of non U.S. mail freight within Washington is sustained.

[2] Taxpayer also requests cancellation of the use tax on the purchase of aircraft and repairs. 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 order to avoid paying use tax, Taxpayer has the burden to establish that its use of the aircraft qualifies for a tax exemption. In this case, Taxpayer must establish that it qualified for the use tax exemption allowed aircraft primarily used in interstate commerce.

The Legislature has chosen to exempt private carriers from use tax if the carrier's business is "conducting interstate commerce by transporting therein or therewith property or persons for hire." RCW 82.12.0254 states in pertinent part:

> 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 exemption from use tax for carrier property used primarily in transporting property in interstate or foreign commerce, RCW 82.12.0254. It provides:

> The use tax does not apply upon the use of airplanes, . . . including component parts thereof, which are used primarily in conducting such businesses.

As we explained in Det. No. 940226, 15 WTD 65 (1995):

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[5] Taxpayer has not provided any documentation to refute the Audit Division's conclusion that the revenue taxed was earned intrastate. If however, that were the case and Taxpayer can provide documentation, Taxpayer may file a claim for refund. However, the refund claim must be filed within the nonclaim period. WAC 458-20-100(2)(a) provides that "[a] petition for refund of taxes must be filed within four years after the close of the tax year in which the taxes were paid."

> 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.
>
> Therefore, if the taxpayer primarily used the aircraft to conduct interstate commerce by transporting therein property or persons for hire, the aircraft is exempt from use tax.

(Footnotes omitted.) Taxpayer has maintained that over 50% of the operation of each aircraft taxed was interstate commerce, thus making the aircraft and its repairs exempt from retail sales tax/or use tax. However, no documentation has been presented to substantiate the claims. . . .

DECISION AND DISPOSITION:

Taxpayer's petition is denied

Dated this 30th day of March 2004.

STATE OF WASHINGTON DEPARTMENT OF REVENUE