

Cite as Det. No. 19-0073, 40 WTD 178 (2021)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 19-0073
)	
...)	...
)	

RULE 211; RCW 82.04.050: RETAIL SALES TAX – USE TAX – EXEMPTION – AIRCRAFT PURCHASED FOR RESALE OR LEASE – INTERVENING USE. Aircraft purchased for resale or lease is not subject to use tax as long as the aircraft is not put to intervening, non-exempt use. 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.

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.

Roberts, T.R.O. – A company that provides piloting and flight training services protests assessment of use tax on its aircraft, arguing that the aircraft was used solely for leasing in the regular course of business and that there was no intervening personal use of the aircraft. The petition is denied.¹

ISSUE

Did a corporation hold an aircraft solely for leasing in the regular course of business, which is exempt from retail sales tax under RCW 82.04.050, or did it discontinue leasing as a business activity and allow the son of the corporation’s member to put the aircraft to his own personal use?

FINDINGS OF FACT

... (“Taxpayer”), is a corporation formed in the state of Washington in January 2008. [Taxpayer provides piloting and flight training services.] Its governing persons are [Owner 1] and [Owner 2]. On April 30, 2015, Taxpayer purchased, and received in-state delivery of, ... (“Aircraft”) for the purchase price of \$ Taxpayer does not possess a reseller permit for the lease of aircraft.

In October 2017, the Department’s Compliance Division (“Compliance”) conducted an investigation of Taxpayer’s aircraft use in Washington State for the period of May 1, 2015 through May 31, 2015. Taxpayer had no tax reporting account with the Department until December 8,

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

2017, when Taxpayer submitted a business license application upon request by Compliance. Taxpayer has not submitted any tax returns or payment with the Department from 2014 through 2017, alleging that its business during this time period was conducted outside of Washington.

According to the flight time log, the Aircraft made approximately 19 flights in Washington from May 2015 through July 2015, prior to the Aircraft's removal to [out-of-state]. Taxpayer states that the initial flights were test and acceptance flights, and that the remaining Washington flights were training flights for [Son], the son of [Owner 1].

An undated Aircraft Lease Agreement stipulated that [Son] would pay Taxpayer an hourly rental payment in the amount of \$. . . per Tach Hour, exclusive of fuel and oil costs.² The Agreement is signed by [Owner 1] as Member of Taxpayer and [Owner 1] for [Son], Pilot.³ The term of the Agreement was to commence upon an unspecified delivery date and continue for a period of 72 months. A Delivery and Acceptance Certificate is set forth at the end of the Agreement, which provides that [Son] accepted the delivery of the Aircraft as of May 1, 2015. It is also signed by [Owner 1] on behalf of [Son].

Taxpayer provided annual invoices for the rental of the Aircraft to [Son], showing the rental of an overall 191 hours at a rate of \$. . . per hour, and totaling \$. . .⁴ Taxpayer states that it has escrowed the estimated 8.5% retail sales tax collected on these invoices in the amount of \$. . . , but was uncertain whether to report the tax in Washington or [out-of-state].

Taxpayer additionally provided 15 invoices from [Third-Party Aviation Company] to various customers, dated from January 2016 through May 2016, for the rental of the Aircraft in [out-of-state]. [Third-Party Aviation Company] leased the Aircraft out to customers on Taxpayer's behalf.] The invoices total \$. . . before the applicable [out-of-state] tax. The rental rates charged were different than those charged to [Son], showing unit costs of \$. . . , \$. . . , and \$. . . , with no itemized description for each charge.

Taxpayer states that the income from the rental of the Aircraft is also reflected in its federal tax returns. Taxpayer provided copies of IRS Form 1120S for the years 2015 and 2016. However, the amounts reported in the IRS returns do not coincide with the invoiced amounts provided by Taxpayer and, for 2016, the amounts reported to the IRS are lower than the amounts shown on the invoices.

While in [out-of-state], the Aircraft went into overhaul and was grounded from June 2016 through November 2017, upon which time it was returned to Washington.⁵ In July 2017, Taxpayer paid retail sales tax in [out-of-state] on the extensive repair work to the Aircraft. Compliance found that the payment of retail sales tax was inconsistent with the practices of leasing an aircraft, as such

² Taxpayer states that this rate is comparable to the rates charged by certain flight instructors in . . . WA, and [out-of-state].

³ Taxpayer asserts that he has authority to sign on [Son]'s behalf, and that [Son] can provide an affidavit to that effect.

⁴ The three annual invoices can be summarized as follows: (1) Invoice # . . . , dated December 31, 2015, for 106.3 total hours and in the amount of \$. . . and \$. . . in retail sales tax; (2) Invoice # . . . , dated December 31, 2016, for 61.9 total hours and in the amount of \$. . . and \$. . . in retail sales tax; and (3) Invoice # . . . , dated December 31, 2017, for 23.7 total hours and in the amount of \$. . . and \$. . . in retail sales tax.

⁵ The Aircraft was sold to . . . , on December 19, 2017.

repair work purchases are generally made for resale without tax. In response, Taxpayer asserts that the [out-of-state] business doing the repairs required retail sales tax to be paid to them.

Based on the results of this investigation, Compliance determined that Taxpayer's purchase of the aircraft was for personal use, to instruct [Son] to fly and attain commercial pilot status, and that Taxpayer was attempting to structure a lease transaction after the fact to avoid use tax on the Aircraft. Compliance found the lack of a business registration in either Washington or [out-of-state] did not support a claim of a business transaction. Further, Compliance viewed the Aircraft Lease Agreement and financial documents to be self-serving and internally inconsistent. Thus, Compliance issued a tax assessment dated January 31, 2018, in the amount of \$. . . , for use tax on the purchase of the Aircraft.⁶

On February 26, 2018, Taxpayer protested the entirety of the assessment. Taxpayer alleges all use was for the rental of the Aircraft for the purposes of flight training, and that there was no intervening personal use. Specifically, Taxpayer asserts that [Son] was a bona fide renter of the Aircraft.

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" is statutorily defined as "any transfer of the ownership of, title to, or possession of property for a valuable consideration," including a "lease or rental." RCW 82.04.040(1).] A sale to a person who "[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)(i). 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, a taxpayer must also meet the "without intervening use" condition. RCW 82.04.050(1)(a)(i). 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.⁸ Det. No. 04-0145R, 24 WTD 400, 405 (2005); see also

⁶ The \$. . . tax assessment is comprised of \$. . . in use/deferred sales tax, a \$. . . delinquency penalty, a \$. . . assessment penalty, and \$. . . in interest.

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(6).

⁸ With respect to tangible personal property, "use" means ". . . the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include[s] . . . any other act preparatory to subsequent actual use or consumption within this state." RCW 82.12.010(6)(a). "Consumer" is defined in RCW 82.04.190(1) to include "[a]ny person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of the person's business"

Excise Tax Advisory 3005.2009 (“ETA 3005”). 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. RCW 82.12.010(6)(a); RCW 82.12.020(1)(a). The use tax is due upon the removal of the item from inventory. *See* Det. No. 91-044, 10 WTD 395 (1990).

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. Dep’t of Revenue*, 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.

Id.

More specific to the exception from retail tax for the lease, rental, or bailment of personal property, Rule 211(3) 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 Excise Tax Advisory 3044.2009 (“ETA 3044”), the Department addresses the potential use tax liability with regard to the purchase of aircraft for the purposes of leasing it to third parties:

A transaction is taxed as a “lease or rental” where the agreement grants to another the right of possession to and use of a bare (without pilot) aircraft for a consideration. In case of outright sale, lease, or rental, where an aircraft is held exclusively for these purposes the dealer incurs no liability for this state's use tax. Taxable “use” includes, for example, demonstration, student flight training, charter flights and air taxi services.

In Det. No. 94-226, 15 WTD 65, 7 (1995), the Department again noted that, 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 for the lease of the aircraft pursuant to lease agreements under which the student pilots assume possession and control of the aircraft. *Id.* 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. *Id.* Instead, the taxpayer should collect retail sales tax on the aircraft rental payments and pay retailing business and occupation (“B&O”) on that portion of its gross receipts.⁹ *Id.*

Here, Taxpayer claims that its use of the Aircraft qualifies for the purchase for resale exception from retail sales tax, asserting that there has been no intervening personal use of the Aircraft. However, we find that Taxpayer has provided insufficient evidence to show that Taxpayer held the Aircraft for lease in the regular course of business on May 1, 2015 through July 2015, prior to the Aircraft’s removal to [out-of-state].

It was during this time that Taxpayer asserts that it leased the Aircraft to [Son]. The Aircraft Lease Agreement indicates that it is for the lease of the Aircraft only, and does not provide for any accompanying flight instruction. However, because [Owner 1] signed on both the behalf of Taxpayer and [Son], because Taxpayer has provided no documents substantiating the lease payments by [Son] for the period in question, and because Taxpayer has never submitted applicable retail sales tax and retailing B&O tax for the lease of the Aircraft to the State of Washington, we find that Taxpayer’s lease to [Son] appears to be illusory. To substantiate the lease, Taxpayer must provide additional documents in support, such as (1) documentation that Taxpayer received lease payments from [Son], e.g., in the form of cancelled checks or bank statements; (2) documentation that [Owner 1] had authority to sign the lease agreement on [Son]’s behalf; and (3) a breakdown of Taxpayer’s leasing income to show that it was correctly reported on Taxpayer’s federal tax returns. Moreover, Taxpayer should document how each of the Washington flights after the Aircraft’s purchase was conducted solely in connection with the alleged lease. Here, it is unclear whether this is the case.

Absent such documentation, we find that [Son]’s use of the Aircraft constitutes personal intervening use by Taxpayer. On this basis, we must conclude that there was taxable use of the Aircraft as of May 1, 2015.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 7th day of March 2019.

⁹ In ETA 3005, the Department provides a similar example as to the applicability of use tax when an article of tangible personal property is acquired for a purpose that is exempt from use tax and subsequently put to use by the owner as a consumer:

M, an airplane rental company, purchases airplanes that it will rent to third parties. The rental of the airplane is a retail sale Assume M gives flying lessons using the plane it had purchased without paying retail sales tax. The income from providing flying lessons is subject to business and occupation tax under the service and other activities classification. RCW 82.04.290(2). Accordingly, M would be using the airplane as a consumer under RCW 82.04.190(2)(a) and it is liable for the use tax on the full value of the airplane when it is first used for providing flying lessons.