STATE OF CALIFORNIA

105.0046

BOARD OF EQUALIZATION

APPEALS SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
G--- R--- Aviations, Inc.	)	No. SR -- XX-XXXXXX-010
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Paul O. Smith, Staff Counsel on May 8, 1995, at San Mateo, California.

Appearing for Petitioner: E--- S---
Attorney At Law

Appearing for the
Sales and Use Tax Department: Dennis Low
Supervising Tax Auditor

Christa Spinali
Tax Auditor

Type of Business: Aircraft purchaser/lessor

Protested Items

The protested tax liability for the period April 1, 1991 through September 30, 1991, is measured by:

	Items	Amount
A.	Actual purchase price of Cessna 421B, FAA registration –XX--P.	$ 132,000
B.	Actual purchase price of Beechcraft King Air C90A, FAA registration –XXXXX-.	1,622,243
Total		$1,754,243

Petitioner's Contentions

Petitioner contends that because the Cessna aircraft was not used in this state until it was leased to a common carrier, the aircraft qualifies for the aircraft exemption. Petitioner also contends that the Beechcraft aircraft was leased to a common carrier, and likewise qualifies for the aircraft exemption.

Summary

A bill of sale filed with the Department of Transportation (hereinafter "DOT") shows that on or about April 22, 199X, petitioner G--- R--- Aviation, Inc., an --- corporation, acquired a Cessna 421B (hereinafter "Cessna"), registration number –XX-- from T--- A--- of D---, Inc. The sales invoice shows that on the date of sale petitioner had a--- ---, California address, and the seller operated out of the --- County, and --- --- County, Ohio airports. Petitioner paid $132,000 for the aircraft, and title to the Cessna passed to petitioner in this state.

On October 1, 1992, petitioner and F---, Inc. (hereinafter "F---") entered into an "Aircraft Lease & Usage Agreement (100% F--- Usage)". Under the agreement petitioner leased the aircraft to F--- and received rentals of $325 per flight hour from F---. If petitioner leased back the aircraft, it paid rent of $325 per flight hour to F---. In addition, petitioner was required to pay an agreed upon amount for pilot services, and miscellaneous fees and expenses. The personal flight logs of Mr. G--- E. M---, petitioner's sole shareholder, show that during the period April 22, 1991 through April 21, 1992, he operated the Cessna for 310 flight hours. In an affidavit dated May 4, 1993, Mr. M--- stated that the intent in acquiring the aircraft was to lease it to a common carrier. He further stated that the aircraft had to have major maintenance work in 1991 and 1992, and consequently the aircraft could not be leased to a common carrier until October 1, 1992.

Another bill of sale filed with DOT shows that on or about September 18, 199X, petitioner acquired a Beechcraft King Air C90A (hereinafter "Beechcraft"), registration number N5639K, from Mr. M---. Petitioner paid $1,622,243 for the Beechcraft. On this same date, petitioner and F--- entered into an "Aircraft Lease & Usage Agreement (100% F--- Usage)". The agreement required F--- to pay petitioner rent of $505 per flight hour, and for petitioner to pay F--- rent of $461 per flight hour. In addition, petitioner was required to pay an agreed amount for pilot services, miscellaneous fees and expenses, if any, for those occasions when petitioner rents the aircraft from F---. There is no showing where a transfer of possession of or title to the aircraft occurred. The lease agreement states the aircraft would be based at the Oakland International Airport, Oakland, California.

On June 1, 199X, the parties entered into another lease agreement that was similar to the first agreement, except that the rent payable by F--- was reduced from $505 to $461 per flight hour, and the aircraft was to be based in Hayward, California rather than Oakland, California. In most flights, petitioner is shown as the customer (for the period September 13, 1991 to August 31, 1992, 329.1 flight hours, petitioner was customer for 247.3 flight hours), and the corresponding monthly leaseback report prepared by F--- show petitioner's flight hours as nonrevenue ("nonrevenue" time means the aircraft was used by the owner in noncommon carriage operations).

In the affidavit of May 4, 1993, Mr. M--- also stated that petitioner's gross receipts for the first 12 months of the lease of the Beechcraft were $167,814.80. Audit schedule 12D, however, shows that petitioner paid $114,005 to F--- during the period September 1991 through August 1992. Mr. M--- also stated that petitioner did not use the aircraft during this period; it was used by employees and guests of M--- D--- & Co., a California limited partnership in which Mr. M--- has a non-controlling interest, P--- F---, members of the P--- Group, and A--- Aviation and others. Mr. M--- further asserted that for convenience F--- billed petitioner for flights by the employees and guests of M--- D--- & Co., and himself. Initially Mr. M---, and M--- D--- & Co., paid F--- directly for their respective flights, and thereafter petitioner paid F--- directly and then billed M--- D--- & Co., and Mr. M--- for their respective portions.

In a letter dated June 4, 1993, petitioner stated, among other things, that any special financial arrangement for the use of the aircraft is immaterial to determine common carriage use. In another letter dated June 2, 1995, petitioner focused on whether the Beechcraft was subject to tax. Petitioner stated that although it was listed in the aircraft's flight logs as the customer, the Beechcraft was actually chartered to M--- D--- & Co. and Mr. M---, and should qualify as common carriage even though F--- charged them a lower rate than charged to the general public. Submitted with this letter, among other things, was a copy of F---'s Air Carrier Certificate issued by DOT on June 27, 198X; an advertising brochure showing the nature of F---'s charter operation; a copy of F---'s charter rates for Hayward, California[1]; and an original schedule of charter rates for Portland, Oregon, as of July 11, 199X. It does not appear that any of the material relates to the period in issue.

The Sales and Use Tax Department (hereinafter "Department") examined petitioner's Beechcraft records and determined that F--- classified its flying hours as charter, owner, and other, and petitioner's flights were accounted for as nonrevenue flight hours. During the initial twelve month operating period petitioner's flight hours accounted for approximately 78 percent of the Beechcraft's operational hours. On May 15, 1995, the Department submitted the following summary schedule[2]:

---

[1] It is not stated whether the Beech King Air C90A listed in this rate schedule is the same aircraft in issue. If so, the rate listed for this aircraft is $625 per flight hour. At a conference with the Department, petitioner's representative stated the hourly rate charged the general public was $700 plus per flight hour.

[2] The first 12 consecutive months should, if possible, be for a 365 period. Accordingly, this schedule is incomplete

1. First operational use: September 18, 1991.
2. Test period: September 18, 1991 to August 31, 1992.
3. Total Flight hours: 329.1.
4. Total non-operational hours: 12.4.
5. Total operational hours: 316.70.
6. Qualifying operational use hours: 25.7.
7. Non-qualifying operational use hours: 291.0.
8. Qualifying use percentage: 8.1 percent.
9. Non-qualifying use percentage: 91.9 percent.
10. Hours in dispute: 291.0 hours with customer identified as petitioner (247.3); Mr. M--- and Mr. D--- D--- (41.6); and Mr. M--- (2.1).

On November 5, 1993, the Department issued a Notice of Determination to petitioner, and on December 3, 1993, petitioner submitted its Petition for Redetermination.

Analysis and Conclusions

Revenue and Taxation Code section 6201 imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for the purpose of such storage, use, or other consumption. The gross receipts from the sale of an aircraft by a person not required to hold a seller's permit is exempt from the sales tax, but the purchaser's use of the aircraft is subject to use tax unless an exemption applies, (Rev. & Tax. Code, § 6283). Use tax also applies where the sale occurs in California but there is no "local participation" as explained in Regulation 1620(a)(2)(B).

Here, there is no evidence that the seller of either the Beechcraft or Cessna held a seller's permit (I doubt if either seller would be required to hold a seller's permit), and there is no evidence of any local participation in either sale. Thus, both aircrafts are not subject to sales tax. Because the Cessna and Beechcraft were clearly purchased for use in California, absent a qualifying exemption, they are both subject to use tax.

Petitioner argues that the Beechcraft qualifies for the common carrier exemption provided by section 6366.1, but makes no such claim regarding the Cessna. Petitioner states that the intent in acquiring the Cessna was to lease it to a common carrier; but because of major maintenance work conducted in parts of 1991 and 1992, the aircraft could not be leased until the latter part of 1992.

---

because it is only through August 31, 1992, and does not include the flight logs through September 16, 1992. (See Audit Workpapers, Attachment 9). However, even if the additional flight hours after August 31, 1992 are classified as for common carriage flights, the qualifying use percentage would still be well under 50 percent. Therefore, no adjustment of the schedule is necessary.

The common carrier exemption provided by section 6366.1 must be satisfied on the basis of whether during the aircraft's first twelve months of operations, more than one-half of the operational use was in common carriage operations. (Rev. & Tax. Code, § 6366.1; Cal. Code Regs., tit. 18, reg. 1593, subd. (b).) The term "common carrier" means any person who engages in business transporting people or property for hire while offering his services indiscriminately to the public or some portion of the public. (Cal. Code Regs., tit. 18, reg. 1593, subd. (a); Civil Code § 2168; 49 U.S.C. 1301; 14 C.F.R. 135.1.1; and Smith v. O'Donnell (1932) 215 Cal. 714). The term "operational use" means actual time during which the aircraft is operated, but excluding test flights, maintenance, personnel training and storage. (Sales and Use Reg., § 1593, subd.(b)(1).)

The personal flight logs of Mr. M--- show that during the period April 22, 1991 through April 21, 1992, he operated the Cessna for 310 flight hours. This extensive use of the aircraft contradicts the implication that the aircraft was inoperable until October 1992. Further, the nature of operation by Mr. M--- was personal use, not common carriage. Therefore, I conclude that the Department's determination as to the Cessna was correct. I now discuss petitioner's argument regarding the Beechcraft.

Section 6366.1 provides in relevant part that there are exempted from the tax, the gross receipts from the sale of aircraft which is sold to persons for the purpose of leasing such aircraft to common carriers of persons or property operating under the authority of this state or the United States. This section also provides that it shall be rebuttably presumed that the aircraft is not regularly used in the business of transporting for hire property or persons if the yearly gross receipts of the lessor from the lease of the aircraft to persons using the aircraft as a common carrier of property or persons does not exceed 10 percent of the cost of the aircraft to the lessor, or $25,000, whichever is less. (Rev. and Tax. Code, § 6366.1, subd.(c); see also Cal. Code Regs., tit. 18, reg. 1593, subd. (b)(1)(D).) Sales and Use Tax Regulation 1593, promulgated to implement section 6366.1, further provides that the exemption will apply only if more than 50 percent of the operational use of the aircraft in the first 12 consecutive months (commencing with the first operational use) was for common carriage purposes.

The Department does not question whether during the relevant period F--- was a common carrier certified by FAA, and I find no basis to question the Department's judgment. Because petitioner's gross receipts from lease of the Beechcraft exceeded $25,000, the provisions of subdivision (c) of section 6366.1 are satisfied. The Department, however, determined that petitioner was not entitled to the exemption provided by section 6366.1, because petitioner was charged a lower rate per flight hour than the rate charged the general public. Petitioner, on the other hand, argues that as long as the use of the aircraft was in common carriage operations, and offered indiscriminately to the public, then any special financial arrangements for the use of the aircraft is immaterial to determine common carriage use. I agree.

This Board has previously held that the charter of an aircraft to an owner or lessor/owner of the aircraft as common carriage when the owner did not receive a preferential rate or some

basis not available to the general public. This is in line with Civil Code section 2170 which provides in relevant part that a common carrier must not give preference in price to one person over another. I do not read section 2170 to be so restrictive that a carrier cannot in any dealings give a price preference to one person over another. I read the statute as prohibiting a carrier from discriminating against the general public, and in favor of the lessor/owner. While a preferential rate given to the owner of an aircraft is an important factor to be considered in determining whether a charter or other contract between the owner or lessor/owner and another party is common carriage, it is not, however, determinative, especially where the preferential rate is not significantly less than the rate available to the general public.

The lease agreement of September 18, 1991, and the new agreement of June 1, 1992, between petitioner and F---, both required petitioner to pay F--- $461 per flight hour. This charge is less than the $700 plus F--- charged the general public. However, the difference in rates diminishes when the amount petitioner should have paid for pilot services, and miscellaneous fees and expenses are considered. The difference in rate, if any, would most likely be insufficient to deny petitioner the opportunity to rely on the exemption provided by section 6366.1. This, however, does not end this matter.

The relevant common carrier provisions are found in Part 135 of Title 14 of the Code of Federal Regulations, and concern operations commonly referred to as "air taxi" or "Part 135". A Part 135 operator must comply with all the rules of Part 135. (14 C.F.R. § 135.3(a).) In the aviation industry, many persons who are air taxi operators also conduct business renting aircraft, provide flight instruction with a pilot and an aircraft, etc. Thus, the specific purpose of each particular flight must be stated; it is not sufficient to show that the air taxi operator was in general possession of the aircraft, such as pursuant to a lease. Exemptions and deductions are solely a matter of legislative grace, and as such must be strictly construed against the taxpayer. (See Hotel Del Coronado v. State Board of Equalization (1971) 15 Cal.App.3d 612, 617.)

Here, petitioner was required to pay an agreed upon amount for "pilot services" for those occasions when petitioner "rented" the Beechcraft from F---. Under the agreements between petitioner and F---, F--- would have lost money on its rentals to petitioner unless it was reimbursed for pilot services. I have not been provided with copies of F---'s invoices to petitioner, and therefore cannot say with certainty that F--- billed such charges to petitioner. However, it is likely that either pilot services were billed to petitioner, or that petitioner paid the pilots directly. In a true common carriage arrangement, it is not customary for pilot services to be separately charged. Also, the contract uses the term "rents" rather than "charters" to describe the use of the aircraft by petitioner.

In order for Part 135 to be applicable to the flight of an aircraft, each carrier must have "the sole possession, control, and use of it for flight..." (14 C.F.R. § 135.25(c).) For example, when an aircraft is rented to a customer even with a pilot but for a separate fee, and the customer has ultimate control over the aircraft and pilot for passenger and or cargo flights which are flown only pursuant to Part 91 rules, the customer's flights are not for common carriage purposes.

Thus, when petitioner rented the Beechcraft and paid a separate fee for pilot services, I am convinced that petitioner had ultimate control over the aircraft and pilot, and the flights were not for common carriage purposes.

Under Part 135 it is the carrier who prepares and maintains a manual and other records containing operational specifications and procedures, a list of each aircraft used in Part 135 operations, and a list of each pilot authorized to fly in such operations. (14 C.F.R. § 135.21, .23, and .63(a).) As examples of more stringent Part 135 rules, a written load manifest must be prepared prior to the flight, and must be retained; certain operating equipment must be part of the aircraft before the flight and/or during the flight; certain pre-flight briefings must be made to the passengers; and certain weather conditions cannot exist before the flight. Further, because the invoices have not been produced, I cannot determine if F---, as required for its Part 135 flights, billed the federal excise tax to petitioner. All of these factors show that it is F--- who must determine whether a particular flight is under Part 135 or Part 91.

Petitioner has not submitted F---'s individual flight logs for each flight which would give more specific information regarding the classification of each flight. However, based on the documentation that has been submitted, we conclude that in each flight in which petitioner was designated by F--- as the customer, F--- was not operating under Part 135. If the flights in which petitioner was the customer were in fact Part 135 flights, then F--- should have designated the flight hours for these flights on its monthly statements as revenue. The use of the word "owner" by F--- on its flight records for flight hours by petitioner implies that F--- did not regard these flights as Part 135 flights. Whenever F--- recorded a flight by petitioner as nonrevenue, F--- was reporting the flight as other than a Part 135 flight. This conclusion is consistent with the requirement in the agreement that petitioner pay for pilot services.

Further, the aircraft's flight logs show petitioner as the customer for approximately 78 percent of the flights hours generated during the first twelve months after operations commenced. (See Audit Workpaper 12A, July 14, 1993.) Because these flight hours were not generated in common carriage, then at no time during the period in issue could common carriage usage of the aircraft have exceeded 50 percent. (Cal. Code Regs., tit. 18, reg. 1593, subd. (b).) Thus, the evidence here does not establish that petitioner is entitled to application of the common carrier exemption provided in section 6366.1.

With respect to the failure to file penalty, I recommend granting petitioner 30 days from the date of the cover letter accompanying this Decision and Recommendation to submit a request for waiver of the penalty. The request must be under penalty of perjury setting forth the facts upon which he bases his claim for relief.

Recommendation

Allow 30 days from the date of the cover letter for submission of a request for waiver of the failure to file penalty, and deny the petition in all other respects.

PAUL O. SMITH, Staff Counsel

September 26, 1995
Date