STATE OF CALIFORNIA

BOARD OF EQUALIZATION **105.0062**

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
	)	No. SP UT XX-XXXXXX-010
C---R. & H--- D. S---	)	
Petitioners	)	

The Appeals conference in the above-referenced matter was held by Paul O. Smith, Staff Counsel on August 19, 1993, in San Francisco, California.

Appearing for Petitioners: J--- M. W---
Attorney At Law

Appearing for the
Sales and Use Tax Department: Alexis A. Viripeff
Supervising Tax Auditor

Carol L. Jaffe
Senior Tax Auditor

Protested Item

The protested tax liability for the determination of June 24, 1991, is measured by:

Item	Amount
Actual cost of a Citation 550 Aircraft purchased for use in California.	$2,070,000

Petitioners' Contention

Petitioners contend that the aircraft was purchased for lease to a lessee for use as a common carrier of persons or property, and was actually used in that manner by a carrier.

Summary

On February 16, 1990, petitioners C--- R. & H--- D. S--- purchased a 1980 Cessna Citation II (-XX-- but since changed to –XXX--), from S--- D--- Jet Center, Inc. (Jet Center), for $2,070,000. Petitioners issued an exemption certificate to Jet Center claiming the aircraft was purchased for lease to a lessee for use as a common carrier. Also on this date, petitioners registered this aircraft to themselves, dba S--- Aviation. Thereafter, S--- Aviation (by J---R---), and A--- M---, Inc. (AMI) as "Certificate Holder", entered into a charter agreement (agreement) for the aircraft. The agreement was for one year, and provided in relevant part that:

petitioners, as the owners of the aircraft, desire to transfer use and control of the aircraft to AMI which will engage in the carriage of passengers for hire;

AMI will obtain certification by the Federal Aviation Administration (FAA) to operate the aircraft in accordance with the requirements of FAR Part 135. Petitioners, at their own cost, agree to make the aircraft available for certification in accordance with the requirements of FAR Part 135, including providing flights and aircraft modification;

aircraft employees of petitioners were assigned to AMI and became "operationally responsible" to AMI;

all direct and reasonable expenses of AMI's personnel, associated with travel, drug testing, training, and maintenance, would be paid by petitioners;

petitioners would maintain the aircraft in compliance with the procedures of AMI and the FAA;

petitioners shall notify AMI, in advance, of aircraft schedules, and "shall account for charter hours flown." "Completed Flight Logs" will be sent to [AMI] within three days following each charter trip"[1];

AMI would pay petitioners' $1,100 per charter hour involving a "retail user", plus the flight crews overnight cost, and petitioners would pay all fixed, direct, and incidental costs incurred in operating the aircraft. AMI would set the charter rates[2], all commercial flights would be invoiced by AMI, including a charge for 8 percent

[1] In correspondence dated August 31, 1993, petitioners' representative stated that "Mr. S--- never "bumped" a charter customer who had booked use of his aircraft." Attached to that correspondence was a letter from AMI which indicated that advanced notice from Mr. S--- precluded booking of the aircraft by a charter customer, and a conflict between Mr. S---'s schedule and a charter customer would not have resulted in Mr. S--- bumping the charter customer. AMI also stated that "On those occasions when we did fly outside charters, our scheduling section would notify S--- Aviation in advance of the charter requests so as to preclude any potential conflict with usage by Mr. S--- and to obtain approval to fly the charter."

[2] AMI's billings were at $1,200 per flight hour, which gave AMI net flight revenues of $100 per flight hour.

federal excise tax, and funds due to petitioners from AMI for third party commercial operation of the aircraft would be remitted along with a full accounting to petitioners on the 25th day of the month following the commercial flight;

all charter advertising would be in AMI's name, subject to petitioners' approval, and the cost would be borne by petitioners; and

AMI established Part 135 operational policies and procedures would be applicable for flight crew and maintenance personnel. Petitioners represented that the flight crew and maintenance personnel in their employ had been directed to comply with AMI's policies and procedures, and agreed to indemnify AMI from all fines, penalties, assessments, costs and expenses resulting from lack of compliance.

In accordance with pilot competency/proficiency testing for FAR 135 purposes, pilot Jerry D. R--- for AMI, on April 20, 1990, March 13, 1991, March 21, 1991, and November 25, 1991, was approved as competent under FAR 135.299, 135.293 and 135.297, 135.293 and 135.299, and 135.297, respectively, by an FAA inspector. On February 14, 1991, petitioners requested of the Board an extension until April 20, 1990, for the start of the 12 month period for determining whether the operational use of the aircraft was more than 50 percent in common carriage. Petitioners contended that this extension was necessary because maintenance work was necessary in order to bring the aircraft, as well as the crew, up to FAA standards. That request was not granted. Attached to this request were, inter alia, flight logs commencing March 22, 1990, and ending April 24, 1990, which indicated that the "operator" of the aircraft during this period was "S--- Aviation".

On November 22, 1991, petitioners submitted an "Analysis Of Aircraft Use", which indicated that the aircraft's flight hours, after completion of repairs by R---, INC., from March 22, 1990 through March 21, 1991, was 209.6. This analysis also indicated that 108.7 of the hours was for common carriage, and such carriage first began on April 23, 1990. On July 16, 1991, petitioners' representative submitted another analysis (attached thereto as Exhibit H), which indicated that passengers were transported by the aircraft as early as March 23, 1990.[3] Petitioners then contended 111.7 of 212.2 operational hours from April 23, 1990 to April 22, 1991, were in common carriage operations. The Department contends that the 50 percent test under Regulation 1593 (b) was not met because only approximately 14.2 percent (29.2 hours) of the operational use was from common carriage operations. These flights were apparently for paying passengers other than petitioners, although Mr. R--- was sometimes the pilot. The Department treated as non-carriage operations the 79.5 hours of flights when petitioners were the

[3] The schedule indicated the aircraft left ---, California, on March 22, 1990, and arrived at --- ---, California, on March 23, 1990. No passengers were carried on this trip. It then left --- --- and went to ---, Montana, on this same date. The passengers were CRS, MS, HL+ (I assume CRS represents Charles R. S---, and HL+ represents HL and additional passengers. The aircraft can carry 8 passengers).

alleged customers with Mr. R--- as the pilot. The Department considered another 96.9 hours as non-carriage because Mr. R--- was employed by petitioner Charles R. S---. On June 24, 1991, the Sales and Use Tax Department (Department) issued a Notice of Determination to petitioners for tax due on the purchase price of the aircraft, and on July 16, 1991, petitioners timely submitted their Petition for Redetermination.

Analysis and Conclusions

Revenue and Taxation Code 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 licensed or certified common carriers of persons or property. 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).)[4]

Sales and Use Tax Regulation 1593, promulgated to implement section 6366.1, provides that the exemption will apply only if more than 50 percent of the operational use of the aircraft in the first 12 months (commencing with the first operational use) was for common carriage purposes. "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 court's comment in Pacific Southwest Airlines v. State Bd. of Equalization (1977) 73 Cal.App.3d 32, 36, that section 6366, "`plainly makes use of the property the basis of the exemption,' the taxpayer's intentions being 'wholly immaterial.' [Citation]", applies equally to section 6366.1. Exemptions from tax are strictly construed against the taxpayer who has the burden of proving that the statutory requirements have been satisfied. (See Standard Oil Company of California v. State Bd. of Equalization (1974) 39 Cal.App.3d 765; H J. Heinz Co. v. State Bd. of Equalization (1962) 209 Cal.App.2d 1.) Any doubt must be resolved against the right to an exemption. Estate of Simpson (1954) 43 Cal.2d 594, 602; J. C. Penny Insurance Company v. State Bd. of Equalization (1979) 94 Cal.App.3d 685, 693.)

The thrust of petitioners' contention is that the transaction qualifies for exemption under section 6366.1 and regulation 1593 because of the lease agreement between the parties. I disagree. In order to qualify for the exemption petitioners, inter alia, must demonstrate that the aircraft was leased to AMI for use in common carrier operations. Although AMI's FAR Part 298 carrier certificate is dated January 28, 1991, which is after the effective date of the charter agreement, and a copy of AMI's Part 135 carrier certificate has not been provided, I find and conclude from the available evidence that AMI held a Part 135 certificate in 1990, and was

[4] I note that petitioners have abandoned the contention stated in their Petition for Redetermination that section 6366 is the applicable statute. This section would apply if petitioners, as owners of the aircraft, conducted common carrier operations. However, this is not the case; petitioners did not possess an FAA Part 135 certificate, and accordingly could not conduct common carriage operations.

qualified to engage in common carrier operations. The FAA provided check rides for Part 135 purposes to Mr. R--- with AMI as the employer on April 20, 1990, and again in 1991. This could only occur if AMI held such a certificate. However, a close examination of the charter agreement indicates that it more resembles something other than a lease agreement. An agreement whereby the lessee does not gain possession and control of the property cannot be a lease agreement, regardless of the labels given to the agreement. (See Vaughan v. Commissioner (1961) 36 T.C. 350, affd. in part and vacated in part (9th Cir. 1964) 333 F.2d 714.) A "lease" is the giving up of possession to the lessee, so that the lessee and not the owner uses and controls the property. (See Cal. Civil Code, §§ 1925, 2985.7; see also Entremont v. Whitsell (1939) 13 Cal.2d 290.)

The agreement provides in relevant part that petitioners are required to pay all fixed, direct, and incidental costs incurred in operation and maintenance of the aircraft. While all charter advertising was in AMI's name, the content of the advertisement was subject to petitioners' approval, and paid for by petitioners. Paragraph 15 of the agreement requires petitioners to account to AMI for all charter hours flown, and to submit to AMI the completed flight logs within three days of each charter trip. The flight logs provided by petitioners indicate that S--- Aviation was the operator of the aircraft, not AMI. In paragraph 17, petitioners further represented that the flight crew in petitioners' employ had been directed by petitioners to comply with AMI's policies and procedures. Most importantly, in AMI's recent letter to me, it was conceded that AMI needed advance approval from petitioners to fly an actual charter for a third-party customer. Thus, it is my conclusion that the agreement and ensuing action effectively resulted in the aircraft and pilots being under the control of petitioners, not AMI. A common carrier qualified under regulation 1593, is the carrier who schedules and approves use of the aircraft, conducts the Part 135 flights, controls the pilots and aircraft during those flights, prepares the Part 135 flight logs, and then accounts to the owner/lessor. Here, petitioners control of the aircraft negates any contention that AMI had the exclusive possession and control of the aircraft necessary for AMI to have conducted Part 135 carriage operations (see 14 CFR, §§ 135.25(c), and 135.77). Thus, all flights conducted with either or both petitioners as the alleged charter customer were not conducted in common carriage operations. The exemption does not apply.

The Department, citing Sales and Use Tax Annotation 105.0060 (May 26, 1969), contends that when Mr. R--- operated the aircraft carrying petitioner Charles R. S--- as a passenger, AMI was not operating as a common carrier within the meaning of section 6366.1. There was no charter of the aircraft to petitioners because Mr. R--- was under the control of petitioners rather than AMI. I agree with this conclusion in view of the above; however, I do not agree that the mere use of Mr. R--- automatically precluded a finding that AMI operated as a common carrier within the meaning of section 6366.1. I believe that the better approach is found in the reasoning of Sales and Use Tax Annotation 105.0040 (June 29, 1992), which relies on Entremont v. Whitsell, supra. Sales and Use Tax Annotation 105.0040 provides in relevant part that if the owner will only lease the aircraft to a common carrier with the owner's pilot required to fly the aircraft, then the owner is providing charter transportation service and is not leasing the aircraft to such common carrier: the owner's insistence that his pilot always fly the aircraft

prevents the lessee from gaining possession and control of the aircraft. However, if there existed an option to lease the aircraft with or without the owner's pilot, and the lease rate was appropriately set; or an agreement in effect that effectively transferred control of the pilot and aircraft to the lessee, then use by the lessee of the owner's pilot should not, by itself, result in a finding that no lease existed between the parties.

Recommendation

Deny the petition.

Paul O. Smith, Staff Counsel Date