

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

105.0293

In the Matter of the Claim for)
Refund Under the Sales and Use) DECISION AND RECOMMENDATION
Tax Law)
)
R--- L. S---) No. SR -- XX XXXXXX-001
LTD. PTN. ET AL.)
dba S--- A---)
)
Petitioner)

This matter came on regularly for hearing before Richard H. Ochsner, Hearing Officer, in Modesto, California on November 15, 1979.

Appearing for Claimant:

Mr. S--- M. M---, Attorney at Law

Ms. M--- M---, Business Manager
C--- L---

Mr. S--- A---, Controller
R--- I---, Inc.

Appearing for the Board:

Mr. Dennis E. Goodman, Tax Auditor III

Claimed Item

By letter of May 15, 1978, a refund of sales tax measured by \$215,000 is claimed.

Contention of Claimant

That the November 1976 sale of a Cessna aircraft, number NXXXXJ, qualifies for exemption under Section 6366.1 of the Revenue and Taxation Code.

Summary of Claim

The claimant partnership commenced business July 1, 1975 and is engaged in sales and rentals of aircraft. It also operates a flight school and makes aircraft repairs. The claimant holds an FAA certificate and operates as an air taxi service. The claimant has been audited for the period July 1, 1975 to December 31, 1977. The issued involved in this claim was considered in that audit. A credit was not granted for the same reasons set forth below as the basis for the denial of the claim.

In November 1976 four individual Modesto businessmen, Messrs. R--- C. D---, J--- C. R---, M--- S. R---, and K--- L. C---, perceived a need for an air taxi service in the Modesto market area employing a five passenger, twin engine, turbo prop aircraft. They decided to purchase a Cessna 340-AII aircraft from the claimant to fill this need.

These individuals formed a partnership, D--- A--- (D,---) on November 8th for the purpose of owning and operating the aircraft. On the same date, D--- entered into an "AIRCRAFT CHARTER AGREEMENT" with the claimant. Under this agreement, the claimant received possession and control of the aircraft and was obligated to operate and maintain it. D--- was obligated to reimburse the claimant for its hangar, fuel, repair and other direct out-of-pocket expenses, other than pilot costs. Further, the claimant agreed to pay D--- \$150 per hour for the use of the aircraft in charter service.

D--- did not directly purchase the airplane, however. After investigating available financing, it was determined that the most favorable terms could be secured from R--- - D--- E---, Inc., dba C--- L--- (C---), a firm in which Messrs. R--- and D--- were principals. Under C---'s line of credit with [name] Bank, these favorable terms could be secured only if C--- and D--- entered into a lease of the aircraft using the standard form supplied by the bank. As a result, C--- purchased the Cessna aircraft No. NXXXXXJ on November 9th from the claimant and the following day leased it to D--- on terms calling for 84 monthly payments of principal in the amount of \$1,854, plus interest on the unpaid balance at the rate of 9-1/2 percent annually. At the end of the 84 months, a balloon payment of \$74,018 would be due and payable in order for D--- to receive legal title to the aircraft.

Although the agreement between C--- and D--- is titled "AIRCRAFT LEASE AGREEMENT", the parties have consistently treated this as a financing arrangement. D---, and not C---, took the investment tax credit at the time of purchase of the aircraft and has taken income tax deductions for depreciation and interest. It did not treat the lease payments as expenses. Unlike all of its other lease equipment, C--- has not taken depreciation deductions on the aircraft.

Sometime in November, C---'s business manager called the Board's Modesto office and explained the nature of the transaction. Tax Auditor III Dennis E. Goodman advised C--- to pay the \$12,900 sales tax reimbursement to the claimant on the purchase and to seek a refund of the tax if the aircraft was used in charter service over 50 percent of the time during the first six months of use. By letter of April 10, 1978, with documentation, C--- stated that the aircraft was flown in charter service 83.6 percent of the time the first six months and requested that the claimant refund the sales tax reimbursement of \$12,900.

On May 15, 1978, the claimant submitted its claim for refund which was denied on the ground that the sale was not made directly to the person who leased the aircraft to the common carrier. It was determined that the Section 6366.1 exemption would not apply if the purchaser leased the aircraft to another lessor who, in turn, leased it to a common carrier.

Analysis and Conclusions

Revenue and Taxation Code Section 6366.1 exempts from sales or use tax aircraft which, inter alia, are sold to persons for the purpose of leasing to lessees using such aircraft as common carriers of persons or property under authority of the United States. This exemption is interpreted by Sales and Use Tax Regulation 1593.

There is no question that the aircraft was used, and is still being used, by the claimant primarily in air taxi service. The exemption was denied solely because the claimant's original sale of the aircraft was not made directly to the person who ultimately leased the aircraft to a common carrier. (Since Revenue and Taxation Code Section 6006.3 defines "lease" as including a rental, hire or license, we conclude that the claimant's aircraft charter agreement with D--- is a "lease" for purposes of the exemption.) Thus, the exemption was denied solely because the sale was made to C---, rather than to D---.

We conclude, however, that nothing in Section 6366.1 prevents the application of the exemption under the circumstances presented here. Section 6366.1 exempts the sale of aircraft "which are leased, or are sold to persons for the purpose of leasing, to lessees using such aircraft as common carriers". Nothing in this language requires a construction which would deny the exemption because of C---'s participation. It is a fact that the aircraft was leased to lessees using it as a common carrier and, further that the sale of the aircraft to C--- was for this purpose. It is also a fact that the sale to C--- was solely for the purpose of providing the necessary financial support for the acquisition and that C--- made no beneficial use of the aircraft inconsistent with the purpose of ultimately leasing the aircraft back to S--- [A---] for use as a common carrier. We do not read the quoted language as requiring that C--- be the entity which makes the lease for use as a carrier. If that interpretation had been intended, the Legislature would not have referred to a sale to persons "for the purpose of leasing". This indirect language leads us to conclude that the sale to C--- falls within the intended limits of Section 6366.1.

Further, we find no conflict with Regulation 1593. Subdivision (h) of that regulation specifically recognizes that the ruling is not an exhaustive list of all exempt situations.

Recommendation

It is recommended that the claim for refund be granted.

Richard H. Ochsner, Hearing Officer

4/21/80

Date