

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

105.0197

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
--- & --- YACHT SALES & CHARTER INC.) No. SP – XX-XXXXXXX-010
)
)
Petitioner)

The Appeals conference in the above-referenced matter was originally held by John Frankot, Staff Counsel on May 28, 1993 in Van Nuys, California. Petitioner was mailed a Notice of Conference dated April 22, 1993. The Notice was not returned as undeliverable. Neither petitioner nor a representative appeared at the scheduled Appeals conference, so it was held with the Sales and Use Tax Department's representative.

On October 8, 1993, Mr. D--- F--- phoned the Appeals Unit regarding the Notice of Conference for May 28, 1993, that he had received the day before. It was determined that a second Appeals conference was necessary, and one was held in Van Nuys on January 14, 1994.

Appearing for Petitioner: D--- F--- President
G--- -, F--- Secretary/Treasurer
J--- -, L--- Chief Pilot

Appearing for the
Consumer Use Tax Department: Ira Anderson, CPA
Supervising Tax Auditor

Protested Item

The protested tax liability for the date of purchase 2/8/90 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Actual cost of aircraft purchased for use in California	\$XX,XXX

Petitioner's Contentions

1. Petitioner contends that the purchase of the aircraft is exempt under Revenue and Taxation Code Sections 6366 and 6366.1¹, because it was used in common carrier operations.
2. Petitioner contends that the Consumer Use Tax Department's classification of certain aircraft usage hours is not in compliance with Sales and Use Tax Regulation 1593², and does not correctly reflect the actual operation of the aircraft.
3. Petitioner contends that the Consumer Use Tax Department's treatment of test, maintenance, and modification/repair or replacement flights is not supported by Regulation 1593.

Summary

Petitioner purchased a 19XX Piper model number PA31-P Navajo, Tail Number XXX--, from a private individual in California on February 8, 199X. Petitioner asserts that the purchase qualifies for exemption under sections 6366 and 6366.1, because the aircraft was purchased for use in Federal Aviation Administration (FAA) Part 135 charter operations.

Petitioner provided the Consumer Use Tax Department (Department) two flight log summaries and copies of flight logs. After reviewing the first summary, the Department concluded that the aircraft did not qualify for exemption. After reviewing the second, amended summary, the Department prepared an Analysis of Aircraft Use for the first 12 months of use, commencing with the first operational use. The Department calculated a charter use percentage of 15.83%, less than 1/2 of the operational use of the aircraft during the test period, and again concluded that the aircraft did not qualify for exemption.

The Department states that petitioner's first operational use of the aircraft occurred on February 23, 199X. Petitioner considers this "ferry flight" a maintenance flight on the amended flight log summary. The Department also notes that a flight classified as a private trip on the original flight log summary was reclassified to a maintenance/training flight on the amended flight log summary. Petitioner asserts that all flights listed as maintenance flights on the amended flight log summary should not affect the exemption, as specified under Regulation 1593(c), "Test Flights", or Regulation 1593(d), "Modification, Repair or Replacement".

¹All further code references are to the Revenue and Taxation Code.

²All further references to Regulations are to Sales and Use Tax Regulations.

The Department states that petitioner has not provided documentation showing that claimed maintenance flights were test flights made to verify that the aircraft performed in accordance with specifications, and/or were for the purpose of modification, repair or replacement to the aircraft. The Department concedes that the maintenance log and repair invoices show that many repairs were made, but contends that proof of test flights is lacking. The Department concludes that all flight hours claimed as maintenance are “ferry flights”, made to and from repair facilities. The Department states that Regulation 1593(b)(1)(A) does not exclude ferry flights from operational use.

The Department classifies five flights between July 20, 199X and September 3, 199X, listed on the amended flight log summary as non-revenue operations, as operational use. The same flights were listed as personal flights on the original summary. The Department states that no documentation (such as sworn statements from passengers) is available to prove the status of these flights. According to the Department, a non-revenue flight occurs when a common carrier transports non-revenue passengers, and since petitioner did not engage in transporting persons for hire until December 31, 199X, it was not acting as a common carrier at the time of the claimed non-revenue flights. Petitioner did not receive an FAA Air Carrier Certificate until October 15, 199X.

At the January 14, 1994 Appeals conference petitioner submitted another flight log summary. Petitioner explained that during 1989 a need existed for a light, multi-piston engine IFR air charter operator to serve the A--- Valley and the east side of the Sierras. Petitioner initially expected to operate approximately 240 hours annually.

Petitioner states that a formal letter of intent and an application to operate was sent to the FAA during January 199X, setting a tentative start date at May 30, 199X. On February 11, 199X, petitioner took delivery of a former air ambulance, in need of significant modification and repairs to convert it to air charter service. The airplane was stored at F-- Field, near L---, while being converted, and while numerous mechanical defects (e.g., a bad engine) precluding FAA certification were repaired. Petitioner states that the conversion and repairs took far more time and money than expected, and delayed the start-up of charter operations (FAA wouldn't qualify the airplane for common carrier use, and petitioner could not accept paying passengers, until it was completely repaired). At the Appeals conference, petitioner offered to obtain evidence substantiating the numerous FAA imposed requirements and related delays from the FAA representative that handled the case.

Petitioner contends that under Regulation 1593(b)(1)(A) and (d), test and repair flights, including “ferry flights”, should be excluded from operational use. As examples, petitioner notes that the San Diego maintenance trip (LV 23Feb9X / RTN 13Mar9X) (to the closest Piper dealer), the 14Sep9X flight to Bakersfield for autopilot repairs, and the flights to Cincinnati via Oklahoma City for an engine overhaul, and back through Oklahoma City for new paint and a new interior (LV 16Mar9X / RTN 11May9X), were all necessary to meet FAA specifications.

Petitioner further contends that training and proficiency flights to satisfy FAA certification requirements should be excluded from operational use. Petitioner states that its pilot, John Litton, needed training in this particular type of airplane to meet insurance and FAA requirements. In addition, to remain qualified a check ride with an FAA representative is required every six months.

Petitioner noted that some flights were “multipurpose”, i.e., they served several purposes (maintenance, training, testing, FAA qualification) at once.

FAA certified the aircraft on October 15, 199X. According to petitioner, the Gulf War and the recession both started about the same time, and as economic conditions deteriorated, so did the air charter business. Petitioner only logged 132 total flight hours in a two year period, far less than originally expected. Petitioner sold the aircraft on February 28, 199X, and discontinued the charter business.

At the January 14, 199X Appeals conference, petitioner contended that the October 20, 199X flight for Northrop charter promotion should be considered the first operational use, since it was the first flight after FAA certification. Petitioner contends that only flights after FAA certification should be considered operational use, under Regulation 1593 (b)(1)(A). Petitioner asserts that the twelve month test period should be from October 20, 199X through October 20, 199X, and that the aircraft qualifies for exemption during that period.

Petitioner questions the applicability of Regulation 1593 to a start-up business that needs time to prepare a used aircraft for common carrier service. Petitioner believes that the Regulation was written with commercial airlines in mind; and a commercial airline would normally place a newly-acquired aircraft in service as soon as possible, even if it required extensive repairs (an existing commercial airline would presumably have easier access to sophisticated repair facilities). In addition, petitioner asserts that the definitions and guidelines included in the regulation are vague.

At the January 14, 199X Appeals conference the Department responded to petitioner's arguments, as follows. The first operational use occurred the first time that petitioner flew the airplane, after petitioner took title. However, the Department's representative supports petitioner's position that short training and test flights should be excluded from operational use.

The Department's representative noted that petitioner's arguments depend on how broadly the terms used in Regulation 1593 can be interpreted. If “storage” can be construed to include petitioner's early periods of ownership, when the aircraft sat idle for long periods at Fox Field and at maintenance facilities, while undergoing extensive repairs and modifications to meet FAA requirements, and the “first operational use” is found to have occurred in October 199X, the aircraft may qualify for the exemption.

Analysis and Conclusions

1. Petitioner contends that the purchase of the aircraft is exempt under Sections 6366 and 6366.1, because it was used in common carrier operations.

Section 6201 imposes a use tax on all tangible personal property purchased from a retailer for use in this state, and subsequently used here. Section 6275 defines every person making any retail sale of an aircraft as a “retailer”. Section 6401 exempts sales and purchases from use tax if they are subject to sales tax. Section 6283 exempts from sales tax sales of aircraft by retailers not required to hold a seller's permit.

Since petitioner purchased the aircraft from a private party not required to hold a seller's permit, the purchase is subject to use tax under Section 6201, absent an applicable exemption.

The Legislature enacted section 6366 on the subject of common carriage use of an aircraft, which provides that a sales or use tax exemption can arise when an aircraft is sold to a person who uses that aircraft as a common carrier of persons or property under the laws of California or the United States. Section 6366.1 provides for a similar exemption when the purchaser obtains an aircraft for lease to a lessee who will use the aircraft in common carrier operations. The court in Pacific Southwest Airlines v. State Board of Equalization (1977) 73 Cal.App.3d 32, 36, commented that section 6366, “‘plainly makes use of the property the basis of the exemption’, the taxpayer's intentions being ‘wholly immaterial’. [Citation]”. The same reasoning applies to section 6366.1.

Regulation 1593 interprets these statutes and provides, in part, that:

“(a) The tax does not apply to the sale of and the storage, use, or other consumption of aircraft sold, leased, or sold to persons for the purpose of leasing, to:

(1) persons using such aircraft as common carriers of persons or property under authority of the laws of this state, or the United States or any foreign government;

* * *

(b)(1) COMMON CARRIERS. In determining whether a purchaser or lessee of an aircraft is using that aircraft as a common carrier of persons or property, only that use of the aircraft by the carrier during the first 12 consecutive months commencing with the first operational use of the aircraft will be considered... (emphasis added)

(A) ‘Operational use’ means the actual time during which the aircraft is operated and shall not include:

1. Test flights as described in paragraph (c) below.
2. Modification, repair, or replacement as described in paragraph (d) below.
3. Personnel training as described in paragraph (e) below.
4. Storage.”

The entire regulation is attached as Exhibit A.

Tax exemptions are a matter of legislative grace and must be found in the statutes (see Hotel Del Coronado Corp. v. State Board of Equalization (1971) 15 Cal.App.3d 612). 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 Board of Equalization (1974) 39 Cal.App.3d 765; H.J. Heinz Co. v. State Board 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. Penney Insurance Company v. State Board of Equalization (1979) 94 Cal.App.3d 685, 693).

A total of \$X,XXX of billings were made for qualifying common carrier operations (for flights through February 14, 1991). Subsequently, petitioner billed another \$X,XXX for flights which were claimed to be common carrier operations, through October 13, 1991 (the Department did not analyze any flights after February 14, 1991). Since the Department has not questioned whether petitioner is engaged in business as a common carrier under Regulation 1593(b)(1)(C) or (D), that issue will not be discussed here.

The principal use of the aircraft determines whether it qualifies for exemption. The 12 month principal use test period began with petitioner's first operational use of the aircraft on February 23, 199X. Using petitioner's amended flight log summary and the Department's Analysis of Aircraft Use, flight hours will be reanalyzed here.

Petitioner contends that under Regulation 1593(b)(1)(A) flights to and from repair facilities should be included in non-operational use. The Board considers so called “ferry flights” as operational non-common carrier hours. They are not necessary to make repairs, and Federal Regulations specifically exclude “ferry flights” from common carrier operations (see Section 135.1(b)(3) of Title 14 of the Code of Federal Regulations). I am unable to locate any authorities that support reclassification of these hours.

The Department has accepted a total of 8.1 hours as personnel training, which appears reasonable in the circumstances. Flights claimed by petitioner for maintenance and repair purposes are properly considered operational use by the Department. Flights that qualify as repair flights are directly related to the repair and modification of the aircraft. The four hour flight noted as April 199X on the flight log summary is allowable, because the contractor moved the aircraft to Oklahoma City for further work, directly related to repair and modification of the aircraft. For local maintenance flights, the flight log does not support that they were directly related to maintenance and repairs. If a mechanic's log or some other evidence is submitted to support that these flights were necessary for repair and maintenance purposes, then they could be reclassified to non-operational use.

Flight time claimed as non-revenue operations does not qualify because this exemption generally applies when an aircraft is used by an existing common carrier to show, demonstrate, or promote its common carrier business prior to the time the aircraft is placed in regular common carrier operations. During the period that petitioner claims non-revenue operation hours, petitioner neither had an FAA certificate nor do flight logs or other documentation support that petitioner was using the aircraft to promote its business as a common carrier.

Petitioner's first use of the aircraft in common carrier operations occurred on December 31, 199X. Including that flight and other common carrier operations through February 14, 199X, petitioner accumulated a total of 11.1 hours in common carrier operations.

The totals accumulated on the Department's Analysis of Aircraft Use are adjusted as follows:

<u>Description</u>	<u>Total Flight Hours</u>	<u>Operational Use</u>	<u>Non-Operational Use</u>
<u>Per Department's Analysis</u>	78.2	70.1	8.1
<u>Adjustments Per D&R</u>			
4/90		-4.0	+4.0
<u>Adjusted Totals</u>	<u>78.2</u>	<u>66.1</u>	<u>12.1</u>

Exempt charter hours of 11.1 divided by the total operational use of the aircraft during the principal use test period of 66.1 hours comes to 16.79% common carrier use, which fails to qualify the aircraft for exemption under Regulation 1593(b)(1).

If **all** hours claimed by petitioner as “non-revenue” and “maintenance” (including “ferry”) on the amended flight log summary are considered non-operational, the common carrier ratio does rise above 50% for the test period $[11.1 / (66.1 - 44.5) = 51.39\%]$. However, as noted above there is no authority to support such a reclassification.

If the first operational use is changed to June 20, 199X (listed as “Interstate business trip” on original and amended flight log summaries, and as “Las Vegas Hotel Charter Promotion / Nonrevenue Passenger Charter Demo” on the summary submitted at the Appeals conference), the principal use test would then run through the June 18, 199X flight. My analysis yields insufficient common carrier use during that period ($25.5 / 59.4 = 43\%$) to qualify for the exemption (unless claimed “non-revenue” and “maintenance” hours are reclassified to non-operational).

Only if the first operational use were changed to some time after petitioner received FAA certification, and the 12 month principal use test period were changed accordingly, would the aircraft easily qualify for exemption. This indicates that petitioner intended to use the aircraft for common carrier purposes. However, the 12 month principal use test is a uniform standard by which all similar transactions must be judged, I am bound by its terms, and petitioner's intentions must play a minimal role (see Pacific Southwest Airlines, supra).

Regulation 1593(h) provides as follows:

“OTHER SITUATIONS. This ruling is not intended to be an exhaustive listing of situations in which aircraft shall be exempt from the tax. No inference, either adverse or favorable to the taxpayer, shall be drawn from this ruling as to liability for the tax with respect to aircraft in any situation not specifically considered herein. For special provisions affecting application of tax to aircraft, see Regulation 1610.”

There are other situations in which the use of an aircraft can be exempt. As provided elsewhere in Regulation 1593, sections 6366 and 6366.1 allow for exemptions under certain circumstances when the purchaser is a foreign government or a non-resident of California. Another possible exemption could arise under section 6352 (and the U.S. Constitution) if the aircraft had been used exclusively in interstate or foreign commerce. The facts in this case don't support any of these other exemptions. I know of no other possible exemption or exclusion.

No adjustment can be recommended.

2. & 3. Petitioner contends that the Department's decision to reclassify certain aircraft usage hours, and the Department's treatment of test, maintenance, modification and repair, and other flights, is not supported by Regulation 1593, and does not reflect the true facts and circumstances of the operation of the aircraft.

Based on section 1., above, the Department's analysis is correct, with the exception of the adjustments made therein.

Recommendation

Since petitioner's use of the aircraft during the 12 month principal use test period does not qualify the aircraft for exemption under Section 6366 and 6366.1, redetermine without adjustment.

John Frankot, Staff Counsel
W/Exhibit A

Date