Cite as Det. No. 21-0020, 43 WTD 13 (2024)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	DETERMINATION
	)	No. 21-0020
. . .	)	Registration No. . . .

[1] WAC 458-20-211; RCW 82.12.010: USE TAX – TRUE LEASE – AIRCRAFT. There are four requirements for a "true lease" under WAC 458-20-211 (Rule 211): (1) it must involve a lessor leasing property to a lessee for consideration; (2) the lessee, or its employees or independent operators, must actually take possession of the property and exercise dominion and control over it for the term of the lease; (3) the parties must intend that the property will revert to the lessor at the conclusion of the lease; and (4) neither the lessor nor its employees or agents may maintain dominion and control over the property and actually operate it. Rule 211(2)(f), (3).

The lessor leased property to a lessee for consideration because the lease was for a set term, provided lessee with operational control of the aircraft without lessee gaining any equity therein, required lessee to make regular rent payments, and lessee had no option to purchase the aircraft. The lessee took possession of the aircraft and exercised dominion and control over it for the term of the lease by scheduling flights, hiring pilots, and maintaining the aircraft. The parties intended that the aircraft would revert to the lessor at the conclusion of the lease because such reversion was a negotiated term of the lease. Neither lessor nor its employees or agents maintained dominion and control over the aircraft or operated it, because the lessee always governed travel and the lessor's owner lacked control of the lessee. Because all four requirements are met, the lease constitutes a "true lease."

[2] RCW 82.32.291: PENALTIES – RESELLER PERMIT MISUSE PENALTY. Reseller permit misuse penalty cancelled where the tax upon which the penalty was assessed was cancelled.

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.

Ryan A. Johnson, T.R.O. – A limited liability company formed to acquire and lease an aircraft contests the assessment of use tax on the purchase price of the aircraft and a reseller permit misuse penalty. We grant the petition.[1]

ISSUES

1. Whether a limited liability company has entered into a "true lease" of an aircraft within the meaning of WAC 458-20-211, when it is wholly owned by the chief executive officer ("CEO") and minority shareholder of the company leasing the aircraft, and the CEO is allowed personal use of the aircraft as part of his compensation.

2. Whether a taxpayer is subject to the reseller permit misuse penalty under RCW 82.32.291 on the purchase of an aircraft when it enters into an agreement to lease the aircraft immediately upon acquisition.

FINDINGS OF FACT

Background

. . . [Taxpayer] is a limited liability company formed for the sole purpose to acquire an aircraft and lease it to [Lessee] in support of [Lessee's] business travel needs. Taxpayer is wholly owned by [Taxpayer's Owner] via a living trust for which he serves as trustee.

[Lessee] supplies third-party physicians to hospitals to coordinate care amongst hospital staff and primary care physicians to achieve outcomes, such as improving patient length of stay, reducing readmissions, and reducing the total cost of care. [Lessee] employed a team of more than . . . physicians practicing at more than . . . medical facilities across the United States. At issue in this matter is Taxpayer's lease of the aircraft to [Lessee].

Ownership of Taxpayer and Relationship of the Parties

[Taxpayer's Owner] is the founder and CEO of [Lessee]. In . . . , [Lessee] recapitalized by selling ownership interests to three new equity partners. Thereafter, [Taxpayer's Owner's] remaining equity interest in [Lessee] was held by two separate trusts which each held less than a 1% interest in [Lessee]. [Taxpayer's Owner] continued in his role as CEO of [Lessee], but his decisions became subject to the approval of [Lessee's] new board of directors (the "Board"). The Board has seven members, one of which is [Taxpayer's Owner].

After [Lessee] recapitalized, the Board explored the acquisition of a private aircraft to meet [Lessee's] travel needs. However, [Lessee's] new equity partners did not want [Lessee] to take on the risk of owning an aircraft itself. Instead, the Board proposed an arrangement to [Taxpayer's Owner], wherein [Taxpayer's Owner] would purchase an aircraft and lease it to [Lessee]. In response to the Board's proposal, . . . [Taxpayer's Owner] formed Taxpayer for the purpose of

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

acquiring an aircraft and leasing it to [Lessee]. In . . . , the Board met and, by vote, approved the lease of an aircraft from either [Taxpayer's Owner] or an entity he owned.

The Purchase and Lease

[In 2014], Taxpayer entered into an agreement to purchase the . . . aircraft that is at issue in this matter (the "Aircraft"). Thereafter, Taxpayer applied for and obtained licenses to conduct business in Washington. On . . . , Taxpayer obtained a reseller permit from the Department. Taxpayer closed on the purchase of the Aircraft on . . . , in [another state]. The purchase price for the Aircraft was $. . . . Taxpayer did not pay retail sales tax on the purchase.

At the time the purchase closed, Taxpayer entered into a non-exclusive aircraft dry lease (the "Lease") with [Lessee], allowing [Lessee] to transport the Aircraft to Washington.[2] The Lease is for a one-year term that renews automatically unless either party terminates it in writing. Lease at Sections 2 and 15. Under the Lease, [Lessee] assumes responsibility for the direct operating costs of flights, securing pilots, insurance, and maintenance of the Aircraft during the lease term. *Id.* at Sections 3, 6, and 13. [Lessee] agreed to make monthly lease payments to Taxpayer at the fixed rate of $. . . . *Id.* at Section 3.

Under the Lease, [Lessee] has complete operational control of the Aircraft, meaning the exercise of authority over initiating, conducting, or terminating a flight. *Id.* at Section 7. [Lessee] is further responsible for all technical aspects of operating the Aircraft. *Id.* [Lessee] must return the Aircraft to Taxpayer at the conclusion or termination of the Lease. *Id.* at Sections 10 and 15. The Lease provides for the condition that the Aircraft must be in upon its return. *Id.* at Section 10, Exhibit B. The Lease does not contain any option for [Lessee] to purchase the Aircraft. It also specifies that legal title to the Aircraft remains with Taxpayer for the life of the Lease and that [Lessee] does not gain any equity in the Aircraft or otherwise dilute Taxpayer's equity in the Aircraft by making the monthly lease payments. *Id.* at Section 9.

[Lessee] and Taxpayer computed the monthly lease payments to include a 10% profit margin for Taxpayer on top of covering Taxpayer's imputed cost of capital in acquiring the Aircraft, the Aircraft's annual market depreciation,[3] and other ownership costs such as fees and taxes. The lease factor, or the proportion of the total market value of the Aircraft represented in each monthly lease payment, is 0.91%.[4]

Taxpayer collected retail sales tax from [Lessee] on the monthly lease payments, which it also reported and remitted to the Department. Taxpayer also reported and paid retailing business and

[2] "Dry lease" is a term of art in the aviation industry, which refers to a lease where the lessor furnishes the lessee with an aircraft but no crew to operate it. *See* Federal Aviation Administration Advisory Circular AC 91-37B at Paragraph 5 ("Leasing of an aircraft without the crew is considered to be a dry lease.").

[3] "Market depreciation" reflects the decrease of the value of an asset in the marketplace over time and is based upon market forces. *Three thoughts on Market Depreciation*, Conklin & de Decker, https://www.conklindd.com/t-threethoughtsonmarketdepreciation.aspx (accessed January 26, 2021). It is not to be confused with "tax depreciation," which reflects the reduction of the value of an asset over time from wear and tear by gradually allowing the recovery of the cost of an asset by recording the depreciation as an expense in the owner's books. *Id.*

[4] Taxpayer provided the Department with a breakdown of the calculation of the lease payments, which showed the fair market value of the Aircraft to be $. . . , the price at which Taxpayer purchase it. $. . . / $. . . = 0.00908 = 0.91%.

occupation ("B&O") tax to the Department on the amount of the lease payments. Taxpayer realized an operating profit from its activity of leasing the Aircraft to [Lessee]. However, for federal income tax purposes, Taxpayer realized losses in each year of the Audit Period. Such tax losses were a result of Taxpayer depreciating the Aircraft as an asset in Taxpayer's books. Taxpayer depreciated the Aircraft using the 5-year 200% declining balance accelerated depreciation method. Under this method, Taxpayer deducts the cost of obtaining the Aircraft over its first five years of ownership, with the largest deductions occurring over the initial years of that period.

Taxpayer filed an aircraft declaration of use tax (the "Declaration") with the Department in which it stated that its purchase of the Aircraft was exempt from use tax. As the reason for claiming exemption, Taxpayer listed its reseller permit.

<u>The Audit</u>

The Department's Audit Division ("Audit") reviewed Taxpayer's books and records for the period from January 1, 2015, through December 31, 2018 (the "Audit Period"). Such records included the Lease, a breakdown of the lease payment calculation, Taxpayer's profit and loss statements, and Taxpayer's flight manifests showing the activity of the Aircraft during the Audit Period.

Audit found that the profit and loss statements show federal income tax losses of $. . . in 2015, $. . . in 2016, $. . . in 2017, and $. . . in 2018. The largest expense on each annual statement is "Depreciation Expense." Absent the Depreciation Expense, Taxpayer enjoyed a net operating profit in each year of the Audit Period: $. . . in 2015, $. . . in 2016, $. . . in 2017, and $. . . in 2018. These amounts are net of the retailing B&O tax and retail sales tax Taxpayer paid to the Department on the lease payments.

The flight manifests showed that [Taxpayer's Owner] was present on the Aircraft for 387 of the 462 flights that it made during the Audit Period. The flight manifests additionally demonstrated that a roughly 13% of the total hours that [Taxpayer's Owner] used the Aircraft during the Audit Period were for his own personal use.

Based upon its review, Audit determined that the Lease is not a "true lease" under WAC 458-20-211 ("Rule 211") because it concluded the Aircraft remained under the dominion and control of [Taxpayer's Owner] or his agents. Audit concluded the Lease is not an arm's length transaction because [Taxpayer's Owner] is both the sole shareholder of Taxpayer and the CEO and founder of [Lessee]. Audit contends that Taxpayer is not a substantive operating business as it has no business activity aside from holding the Aircraft and leasing it to [Lessee].

Although the calculation for the lease payments from [Lessee] to Taxpayer attempts to include a 10% profit margin, Audit concluded that Taxpayer's consistent losses throughout the Audit Period shows that the Lease is not motivated by a genuine profit motive. Audit asserts that such conclusion is supported by the fact that [Taxpayer's Owner's] use of the Aircraft represents a large proportion of its overall use, as well as that Taxpayer has neither leased the Aircraft to any person other than [Lessee] nor advertised it as available for lease.

Because Audit concluded that the Lease was not a true lease, Audit determined that Taxpayer was liable for retail sales tax on the fair market value of the Aircraft (because Taxpayer had not immediately resold the aircraft by leasing it to [Lessee]), but not on the lease payments. Audit assessed use tax against Taxpayer for the amount of unpaid retail sales tax on the purchase price of the Aircraft and the value of refurbishments prior to first use in Washington, less the retail sales tax Taxpayer had already paid on the lease payments. Audit also credited Taxpayer for the amount of the retailing B&O tax that it had already paid.

Finally, Audit concluded that Taxpayer had misused its reseller permit in the purchase of the Aircraft. Audit based this upon its prior conclusion that Taxpayer was liable for retail sales tax on the entire sales price of the Aircraft as well as that Taxpayer listed the reseller permit as the reason Taxpayer claimed its purchase of the Aircraft was exempt from use tax on the Declaration.

On . . . , Audit issued an excise tax assessment against Taxpayer for the Audit Period in the amount of $. . . . The assessment comprises $. . . of combined state and local use tax, a $. . . credit for overpaid retailing B&O tax, $. . . of interest, a substantial underpayment penalty of $. . . , and a reseller misuse penalty of $. . . . Taxpayer timely filed a petition for administrative review of the assessment.

In support of the petition, Taxpayer asserts that the Lease meets the criteria to be a "true lease" under Rule 211. Taxpayer asserts that [Taxpayer's Owner] does not control and direct [Lessee]. Despite that [Taxpayer's Owner] founded and is CEO of [Lessee], Taxpayer maintains that [Taxpayer's Owner] has held less than 2% of the ownership interest in [Lessee] since it recapitalized prior to the formation of Taxpayer. Additionally, Taxpayer asserts that [Taxpayer's Owner's] management decisions are subject to the approval or rejection of the seven member Board – of which, there are six other members, and [Taxpayer's Owner's] one vote does not provide a majority of voting interests. Taxpayer maintains that the Lease was recommended by another board member and approved by the Board with the primary consideration of what is best for [Lessee], rather than what is best for [Taxpayer's Owner].

Taxpayer asserts that [Taxpayer's Owner's] personal use of the Aircraft is not intervening use because it is a taxable fringe benefit that is imputed to him as income provided him by [Lessee] as part of his compensation for serving as CEO. In support of this assertion, Taxpayer provided [Lessee's] quarterly Standard Industry Fare Level ("SIFL") reports from the Audit Period and payroll reports detailing taxable fringe benefits provided to [Taxpayer's Owner] by . . . [Lessee]. SIFL is a multiplier that is used to value personal use of business aircraft. Companies must report personal use of company aircraft to satisfy the Internal Revenue Service, the Federal Aviation Administration, and the [Securities] and Exchange Commission reporting requirements. [Lessee's] SIFL reports show the value of [Taxpayer's Owner's] personal use of the Aircraft over the Audit Period, upon which [Taxpayer's Owner] is required to pay federal income taxes. The [Lessee] payroll reports show the value of the taxable fringe benefits provided to [Taxpayer's Owner] are equal to the value of [Taxpayer's Owner's] personal use of the Aircraft detailed in the SIFL reports.

Taxpayer asserts that the Lease was an arm's length transaction motivated by genuine business purposes. Taxpayer maintains that the terms of the lease are reasonable, common within the aviation industry, and were negotiated through the attorneys of Taxpayer and [Lessee] to ensure independence. Taxpayer contends that the Lease's lease factor of 0.91% is typical within the aviation industry and shows that the lease payments are commercially reasonable.

Taxpayer disputes Audit's claim that the losses shown on Taxpayer's profit and loss statements indicate a lack of profit motive. Taxpayer asserts that those statements were prepared for federal income tax purposes and include tax depreciation deductions. Taxpayer maintains that statements show tax losses, rather than true losses and that it operated at a profit from its leasing activity during the Audit Period.

Taxpayer asserts that the transaction provides mutual benefits to both parties. Taxpayer contends that the Lease provides Taxpayer steady cash flow in the form of the monthly lease payments as well as a tax deduction from the depreciation and other expenses of owning the Aircraft. As for benefits to [Lessee], Taxpayer asserts that the lease provides the efficiency of travel without using commercial airlines and avoids negative consequences of keeping such a large asset on its corporate balance sheet. For example, not owning the Aircraft allows [Lessee] greater flexibility in its growth as a company by making it easier to obtain lines of credit and allowing for more precise use of working capital.

Taxpayer further contends that transactions in the same form as the Lease are specifically provided for in the Department's regulations. Taxpayer asserts that under WAC 458-20-280 ("Rule 280") and WAC 458-20-28003 ("Rule 28003"), the Department has recognized leases between related parties. Rule 280 pertains generally to unfair tax avoidance transactions, while Rule 28003 deals specifically with such transactions that are aimed at avoiding the payment of retail sales or use tax. In the event that a person is found to have engaged in an unfair tax avoidance transaction under Rules 280 and 28003, Rule 28003(2) designates a number of scenarios as "safe harbors" in which the Department will not disregard that transaction. One such safe harbor is provided for "certain leasing arrangements." Rule 28003(2)(i). Taxpayer contends that the safe harbor detailed in Rule 28003(2)(i) describes the same arrangement as the Lease and, therefore, the Department has condoned such arrangement and must recognize the Lease as a "true lease" under Rule 211.[5]

Lastly, Taxpayer asserts that it is not subject to the reseller permit misuse penalty because it did not owe retail sales tax on the purchase of the Aircraft.

ANALYSIS

Washington imposes both a retail sales tax and a use tax. Retail sales tax is imposed on tangible personal property purchased by a consumer in this state. RCW 82.08.020; RCW 82.04.050. The use tax complements the retail sales tax and is imposed "for the privilege of using within this state

[5 Based on these facts, the Taxpayer is not engaged in tax avoidance where a taxpayer exercises control over the entity in such a manner that the taxpayer effectively controls the tangible personal property. *See* RCW 82.32.655 and WAC 458-20-28003(2) (sales and use tax avoidance arrangements). Here, the Taxpayer did not exercise control over the Lessee, even though at one point the Taxpayer's Owner, as founder, was in control of the Lessee. *See* RCW 23B.01.400(4) ("controlling interest" defined). Before entering the Lease, the Taxpayer's Owner sold the majority of its interests in the Lessee and kept only a 2% ownership interest, which is not sufficient to establish control under RCW 23B.01.400(4). While the Taxpayer's Owner used the aircraft during the Lease, it did so as the Lessee's agent and its use was always under the dominion and control of the Lessee, either for the Lessee's business purposes or for personal travel as compensation to the Taxpayer's Owner.]

as a consumer . . . [a]ny article of tangible personal property purchased at retail, or acquired by lease, gift, repossession, or bailment . . . " on which Washington retail sales tax has not been paid, unless there is an applicable statutory exemption, deduction or exclusion. RCW 82.12.020(1)(a).

RCW 82.12.010(5)(a) broadly defines "use":

> "Use," "used," "using," or "put to use" shall have their ordinary meaning, and shall mean: (a) With respect to tangible personal property, *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 installation, storage, withdrawal from storage, distribution, or any other act preparatory to subsequent actual use or consumption within this state.

(Emphasis added.) RCW 82.04.190(1) defines "consumer" as "[a]ny person who purchases, acquires, owns, holds, or uses any article of tangible personal property . . . other than for purpose of (a) resale as tangible personal property in the regular course of business. . . ."

The use tax applies to the use of aircraft in this state, whether for pleasure or for business, and whether by a resident or a nonresident, unless the use is statutorily excluded or determined to be otherwise exempt. *See* Det. No. 94-226, 15 WTD 65 (1995). Use tax liability arises at the time the property is first put to use in this state. RCW 82.12.010(6)(a); RCW 82.12.020(1)(a). *See* WAC 458-20-178. When Taxpayer acquired the aircraft [out of state], it did not pay retail sales tax. Thus, once Taxpayer brought the aircraft into Washington – exercising dominion and control over it, use tax on the value of the aircraft became due, in the absence of an exclusion or exemption. RCW 82.12.020.

The renting or leasing of tangible personal property to consumers is a retail sale. RCW 82.04.050(4). Accordingly, a person renting or leasing tangible personal property to a consumer is required to collect and remit retail sales tax on each of the rental or lease payments. RCW 82.08.020(1). *See also* WAC 458-20-211(6) ("Persons who rent or 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.").

Here, Taxpayer asserts that use tax never became due on the aircraft once Taxpayer brought it into Washington, because Taxpayer never used the aircraft as a "consumer." Instead, Taxpayer immediately resold the aircraft by leasing it to [Lessee] and, thus, never used the aircraft as a consumer under RCW 82.04.190(1)(a). Taxpayer asserts that [Lessee] was the consumer of the aircraft and Taxpayer properly collected retail sales tax from [Lessee] on the lease payments and remitted the tax to the Department.

Audit challenges the validity of the lease, for reasons explained above. [If] Taxpayer's lease arrangement with [Lessee] does not constitute a "true lease" [reflecting a] resale in the regular course of business, then it follows that Taxpayer used the aircraft as a consumer and use tax is due upon the value of the aircraft when Taxpayer first used the aircraft by bringing it into Washington.

1. <u>Whether the Lease is a True Lease under Rule 211</u>

Rule 211 is the Department's administrative rule that explains the taxability of persons who lease tangible personal property. Rule 211(2)(a) defines "leasing" as "the act of granting to another the right of possession to and use of tangible personal property for a consideration."

Rule 211 distinguishes between "true leases" and other lease arrangements amounting to installment sales. Under a true lease, retail sales tax is due on each rental payment as it becomes due over the term of the lease. Rule 211(6); Det. No. 99-021, 19 WTD 37, 40-41 (2000). In contrast, retail sales tax is due on the full selling price of the installment sale at the time of sale, even when the buyer pays the tax to the seller in installments over time. WAC 458-20-198(2). To define "true lease," Rule 211(2) provides, in pertinent part:

> (f) The term "true lease" (often referred to as an "operating lease") refers to the act of leasing property to another for consideration with the property under the dominion and control of the lessee for the term of the lease with the intent that the property will revert back to the lessor at the conclusion of the lease.

A true lease does not arise unless the lessee, or employees or independent operators hired by the lessee, actually takes possession of the property and exercises dominion and control over it. Rule 211(3). In circumstances where the lessor of the property or the lessor's employees or agents maintain dominion and control over the property and actually operate it, the lessor is not deemed to have relinquished sufficient control over the property to give rise to a true lease. *Id.*; Det. No. 94-320ER, 23 WTD 307, 315 (2004).

Thus, there are four requirements for a "true lease" under Rule 211: (1) it must involve a lessor leasing property to a lessee for consideration; (2) the lessee, or its employees or independent operators, must actually take possession of the property and exercise dominion and control over it for the term of the lease; (3) the parties must intend that the property will revert to the lessor at the conclusion of the lease; and (4) neither the lessor nor its employees or agents may maintain dominion and control over the property and actually operate it. Rule 211(2)(f), (3).

Here, the Lease is a "true lease" as all four of the requirements in Rule 211(2)(f) and (3) are met.

a. A Lessor Leasing Property to a Lessee for Consideration.

Taxpayer leased the Aircraft to [Lessee] for consideration during the Audit Period. Under the Lease, [Lessee] made monthly lease payments to Taxpayer at the fixed rate of $. . . in exchange for its use of the Aircraft. Lease at Section 3. The Lease is for a one year term that renews automatically, unless either party terminates it in writing. *Id.* at Sections 2 and 15. Thereunder, [Lessee] has complete operational control of and assumes responsibility for all direct costs and all technical aspects of operating the Aircraft during the lease term. Lease at Sections 3, 6, 7, and 13.

The Lease does not contain any option for [Lessee] to purchase the Aircraft, and [Lessee] must return the Aircraft to Taxpayer at the conclusion or termination of the Lease. *Id.* at Sections 10 and 15. [Lessee] does not gain any equity in the Aircraft by making the monthly lease payments, and legal title to the Aircraft remains with Taxpayer. *Id.* at Section 9.

Audit asserts that because Taxpayer's records show that it sustained tax losses in each year of the Audit Period, the Lease was not entered into with a legitimate profit motive. However, Rule 211 does not require a profitable lease in order to establish a true lease, and the fact that Taxpayer did not report annual profits on its federal income tax returns during the Audit Period does not negate that [Lessee's] $. . . monthly payments were consideration paid for lease of the Aircraft.

[Lessee] and Taxpayer computed the monthly lease payments to cover Taxpayer's costs of owning the Aircraft, imputed cost of capital in acquiring the Aircraft, market depreciation, and to include a 10% profit margin for Taxpayer. The payments have a lease factor of 0.91%. We make no finding as to the reasonableness of the lease payments, and [the Department] may, at its discretion, review the lease payments to determine if they are undervalued. Notably, the lease payment calculation provided by Taxpayer shows that the parties did not intend for the payments to cover the tax depreciation on the Aircraft, only the market depreciation. This shows that Taxpayer retains the residual value in the Aircraft as an asset.

Further, the losses shown in Taxpayer's profit and loss reports were tax losses, not operating losses. The $. . . lease payments produced a profit for Taxpayer; however, once Taxpayer calculated its Federal income tax profit/loss and subtracted depreciation of the aircraft from the Lease profits, Taxpayer's profit turned into a loss.

Because the Lease has a set term, provides [Lessee] with operational control of the Aircraft without [Lessee] gaining any equity therein, requires [Lessee] to make regular rent payments, and [Lessee] has no option to purchase the Aircraft, we conclude that Taxpayer leased the aircraft to [Lessee] for consideration of $. . . .

b. The Lessee, or its Employees or Independent Operators, Actually Take Possession of the Property and Exercise Dominion and Control over it for the Term of the Lease.

[Lessee] or its hired flight operators actually took possession of the Aircraft and exercised control over it. Under the Lease, [Lessee] has complete operational control of the Aircraft, meaning the exercise of authority over initiating, conducting or terminating a flight. Lease at Section 7. [Lessee] exercised its dominion and control over the Aircraft by scheduling flights, hiring the pilots who actually operated the Aircraft on those flights, and performing all maintenance of the Aircraft during the term of the Lease. Audit does not dispute that the Lease meets this second requirement of Rule 211(2) . . . .

Because [Lessee] received operational control of the Aircraft under the Lease and exercised that control by scheduling flights, hiring the pilots for those flights, and maintaining the Aircraft, we conclude that [Lessee] or its hired flight operators actually took possession of the Aircraft and exercised dominion and control over it for the term of the Lease.

c. The Parties must Intend that the Property will Revert to the Lessor at the Conclusion of the Lease.

The Lease provides that [Lessee] will return the Aircraft to Taxpayer at the termination of the Lease and sets out requirements for the condition of the Aircraft upon return. Lease at Sections 10 and 15. Section 15 of the Lease provides that "[u]pon the termination or expiration of this Agreement, [Lessee] shall return the Aircraft to [Taxpayer] . . . in as good operating condition as when received, ordinary wear, tear and deterioration excepted." At Section 10, the Lease further provides that, at the time [Lessee] returns the Aircraft to Taxpayer, all of its systems must be "functioning properly" and that [Lessee] must also return all "Aircraft records, logs and other materials previously delivered to [Lessee]."

Additionally, as explained above, [Lessee] does not gain any equity in the Aircraft by making the monthly lease payments and legal title to the Aircraft remains with Taxpayer. Lease at Section 9. Audit does not dispute that the Lease meets the third requirement of Rule 211(2) . . . .

Because Taxpayer negotiated in the Lease that [Lessee] will return the Aircraft to Taxpayer at the termination thereof, as well as the specific condition in which the Aircraft must be at its return, we conclude that the parties intended that the Aircraft will revert to Taxpayer at the conclusion of the Lease.

d. Neither the Lessor nor its Employees or Agents Maintain Dominion and Control over the Property and Actually Operate it.

Taxpayer did not operate the Aircraft during the Audit Period. Taxpayer was formed solely to hold the Aircraft and lease it to [Lessee]. Immediately upon purchasing the Aircraft, Taxpayer entered into the Lease with [Lessee]. Under the Lease, [Lessee] became responsible for all direct operating costs of flights, including hiring pilots to operate the aircraft. Lease at Sections 3. [Lessee], through hired pilots, operated the Aircraft to bring it into Washington, as well as each subsequent flight during the Audit Period.

Audit contends that [Taxpayer's Owner's] use of the Aircraft represents a large proportion of its overall use during the Audit Period and that [Taxpayer's Owner's] consistent personal use of the Aircraft tends to show that Taxpayer has not sufficiently relinquished dominion and control of the Aircraft for the Lease to constitute a true lease under Rule 211. However, Taxpayer has shown through [Lessee's] SIFL reports from the Audit Period that [Taxpayer's Owner's] personal use of the Aircraft was treated as a taxable fringe benefit provided to him by [Lessee], in [Taxpayer's Owner's] executive compensation package as CEO. Accordingly, the SIFL reports establish that [Taxpayer's Owner's] personal use flights on the aircraft do not represent intervening use by . . . [Taxpayer's Owner] or Taxpayer because [Lessee] was operating the Aircraft on those flights and providing the flights to [Taxpayer's Owner] as taxable compensation.

Audit maintains that, because [Taxpayer's Owner] is both the sole shareholder of Taxpayer and the CEO and founder of [Lessee], the Lease is not an arm's length transaction and that the Aircraft remained under the dominion and control of Taxpayer or its agents. However, to so find, we would have to also conclude that [Taxpayer's Owner] controls both [Lessee] and Taxpayer. [Taxpayer's Owner] is the sole owner of Taxpayer and controls Taxpayer.

The question is whether [Taxpayer's Owner] exercised control over [Lessee] during the Lease. Washington's Business Corporation Act, Title 23B RCW, defines control of a business entity as "ownership of an entity's outstanding shares or interests in such number as to entitle the holder at the time to elect a majority of the entity's directors or other governors without regard to voting power which may thereafter exist upon a default, failure, or other contingency." RCW 23B.01.400(4). At one point, [Taxpayer's Owner] was in control of [Lessee] because he founded it. However, before the Lease in question, [Taxpayer's Owner] sold the majority of its interests in [Lessee] and kept only a 2% ownership interest in [Lessee]. Here, [Taxpayer's Owner's] 2% ownership interest in [Lessee] is not sufficient to establish control of [Lessee] under RCW 23B.01.400(4) because [Taxpayer's Owner] is not entitled to elect a majority of [Lessee's] board members. Further, while [Taxpayer's Owner] does hold one seat on the board of directors of [Lessee], there are seven total seats, and [Taxpayer's Owner's] one seat is not a majority. Thus, while [Taxpayer's Owner] did use the aircraft during the lease to [Lessee], [Taxpayer's Owner] did so as an agent of [Lessee], and his use was always under the dominion and control of [Lessee]; either travel to conduct [Lessee] business or personal travel which was treated as compensation to [Taxpayer's Owner] from [Lessee].

Because [Taxpayer's Owner's] travel on the aircraft was always governed by [Lessee] and [Taxpayer's Owner] lacked control of [Lessee], we conclude that neither Taxpayer nor its agents maintained dominion and control over the aircraft nor operated it during the lease. Because we also find that Taxpayer leased the aircraft to [Lessee] for consideration, that [Lessee] or its hired flight operators actually took possession of the Aircraft and exercised dominion and control over it for the term of the Lease, and that the parties intended that the Aircraft will revert to Taxpayer at the conclusion of the Lease, we conclude that the Lease is a "true lease" under Rule 211.

2. <u>Whether Taxpayer is subject to the Reseller Permit Misuse Penalty under RCW 82.32.291.</u>

RCW 82.32.291 requires the Department to impose a 50 percent penalty for improper use of a reseller permit, and provides, in part:

> (1) Except as otherwise provided in this section, if any buyer improperly uses a reseller permit number, reseller permit, or other documentation authorized under RCW 82.04.470 to purchase items or services at retail without payment of sales tax that was legally due on the purchase, <u>the department must assess against that buyer a penalty of fifty percent of the tax due</u>, in addition to all other taxes, penalties, and interest due, on the improperly purchased item or service.
>
> . . .
>
> (3) A buyer that purchases items or services at retail without payment of sales tax legally due on the purchase is deemed to have improperly used a reseller permit number, reseller permit, or other documentation authorized under RCW 82.04.470 to purchase the items or services without payment of sales tax and is subject to the penalty in subsection (1) of this section if the buyer:
>
>> (a) Furnished to the seller a reseller permit number, a reseller permit or copy of a reseller permit, or other documentation authorized under RCW 82.04.470 to avoid payment of sales tax legally due on the purchase; . . . .

(Emphasis added.)

Importantly, the reseller permit misuse penalty is assessed against the retail sales tax due from a taxpayer's misuse of their reseller permit. RCW 82.32.291(1). Here, use tax is not due on Taxpayer's acquisition of the aircraft because this was an exempt purchase for resale, which qualified for use of Taxpayer's reseller permit. Therefore, there is no tax due in this matter upon which we could assess the reseller permit misuse penalty. Accordingly, we cannot find that Taxpayer is subject to the reseller permit misuse penalty under RCW 82.32.291.[6]

DECISION AND DISPOSITION

Taxpayer's petition is granted.

Dated this 27th day of January 2021.

[6] Additionally, we have previously held that the misuse of a reseller penalty under RCW 82.32.291 is not applicable to products that were not subject to sales tax when the purchaser picked-up the products at an out-of-state location. Det. No. 15-0284, 34 WTD 595 (2015).