OHIO BOARD OF TAX APPEALS

PI IN THE SKY, LLC, (et. al.),

Appellant(s),

vs.

JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),

Appellee(s).

CASE NO(S). 2015-2005

(USE TAX)

DECISION AND ORDER

APPEARANCES:

For the Appellant(s) - PI IN THE SKY, LLC
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Entered Thursday, January 19, 2017

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

This appeal is considered by the Board of Tax Appeals upon a notice of appeal filed herein by the above-named appellant, Pi in the Sky, LLC ("taxpayer") from a final determination of the Tax Commissioner. Therein, the commissioner affirmed his previously issued use tax assessment against taxpayer relating to the purchase of a new aircraft. S.T. at 1. The matter is submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript ("S.T.") certified to this board by the Tax Commissioner, and any written argument filed by the parties, as the hearing before this board was waived by all parties. To the extent any attachments to taxpayer's brief, including, but not limited to exhibits 1-7, were not already part of the record certified to this board by the commissioner, they will not be considered for purposes of rendering our decision herein, as they constitute unsworn statements that do not rise to the level of evidence upon which we may rely. See *Lynde v. Tracy* (Dec. 19, 1994), BTA No. 1994-M-111, unreported; *Executive Express, Inc. v. Tracy* (Nov. 5, 1993), BTA No. 1992-P-880, unreported. Further, the record cannot be "supplemented" with such information without the consent of all parties, which has not been demonstrated. Additionally, any written argument by way of brief related to such attachments will be accorded no weight. Accordingly, taxpayer's motion for leave to file a surreply is denied.

The findings of the Tax Commissioner are presumed valid. *Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121 (1989). It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Belgrade Gardens v. Kosydar*, 38 Ohio

St.2d 135 (1974); *Midwest Transfer Co. v. Porterfield*, 13 Ohio St.2d 138 (1968). Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Kern v. Tracy*, 72 Ohio St.3d 347 (1995); *Federated Dept. Stores, Inc. v. Lindley*, 5 Ohio St.3d 213 (1983). Where no competent and probative evidence is presented to this board by the appellant to show that the Tax Commissioner's findings are incorrect, then the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Kern*, supra; *Kroger Co. v. Limbach*, 53 Ohio St.3d 245 (1990); *Alcan*, supra.

Taxpayer is a limited liability company that is the registered owner of the aircraft under consideration herein; taxpayer "was formed for the purpose of holding an aircraft for lease. *** Since its formation to present, the Company [taxpayer] has engaged in no business activity other than the resale (leasing) of aircraft." Brief at 2. Mitchell's Salon and Day Spa, Inc. ("Mitchell's") is the sole member of taxpayer. Mitchell's owner and president, Deborah Mitchell Schmidt, a licensed pilot herself, in her individual capacity, "was the borrower on the loan for the [purchase of the] aircraft." S.T. at 5. Mitchell's entered into a "Non-Exclusive Aircraft Lease Agreement" for the rental of the subject aircraft from taxpayer, with Ms. Schmidt signing as the president of Mitchell's, on behalf of Mitchell's, as the lessee, and as president of the taxpayer, on behalf of the taxpayer, as the lessor. S.T. at 415-425. All flights logged on the aircraft between May 2012 and May 2014 were taken by Mitchell's and no other lessee, including some flights to Ms. Schmidt's out-of-state lakefront home. Taxpayer Brief at 5; S.T. at 5.

In accordance with the provisions of such lease, taxpayer contends that it purchased the subject aircraft for the purpose of leasing it to its sole member, Mitchell's, and others, and as such, the transaction was exempt from sales tax, pursuant to R.C. 5739.01(E) and 5741.02(C), as "tangible personal property purchased for resale in the same form as received, by a person engaging in business." S.T. at 1. The commissioner ultimately concluded that the lease transaction between Mitchell's and taxpayer constituted a sham transaction, pursuant to R.C. 5703.56(A), i.e., "a transaction *** without economic substance because there is no business purpose or expectation of profit other than obtaining tax benefits." As such, the commissioner disregarded taxpayer's lease transaction(s) with Mitchell's and determined taxpayer's liability based upon the sale price paid for the aircraft. R.C. 5703.56(B).

R.C. 5739.01(B) provides that "'Sale' and 'selling' include *** transactions for a consideration in any manner, whether absolutely or conditionally, whether for a price or rental, in money or by exchange, and by any means whatsoever," including, per R.C. 5739.01(B)(1), "[a]ll transactions by which title or possession, or both, of tangible personal property, is or is to be transferred, or a license to use or consume tangible personal property is or is to be granted." Further, R.C. 5739.01(E) goes on to provide the sale-for-resale exception, i.e., that sales are not taxable when "the purpose of the consumer is to resell the thing transferred or benefit of the service provided, by a person engaging in business, in the form in which the same is, or is to be, received by the person." Additionally, "'[b]usiness' includes any activity engaged in by any person with the object of gain, benefit, or advantage, either direct or indirect." R.C. 5739.01(F).

It is the commissioner's position that taxpayer did not engage in a legitimate "business," resulting in taxpayer's lease agreement with Mitchell's declared a sham, and, therefore, the aircraft's purchase was determined not to be a proper sale-for-resale exception to the imposition of sales tax. Taxpayer argues that "[t]here is no valid basis for disregarding the separate corporate existence of the parties, or the lease transaction[s] between the parties, so as to deny the resale exemption." Taxpayer Brief at 5.

As noted by the commissioner in his final determination, "not all leases of aircraft qualify for the resale exception. If the owner of an aircraft furnishes both the aircraft and the operator, the owner remains in possession and control of the aircraft and no 'sale' of the aircraft occurs. See, *Fliteways, Inc. v. Lindley*, (1981), 65 Ohio St.2d 21; *Laurel Transportation, Inc. v. Zaino* (2001), 92 Ohio St. 3d 220. If, on the other hand, the owner of an aircraft furnishes only the aircraft (via a dry lease), the aircraft is considered to be resold when leased and the purchase of the aircraft qualifies for exemption from taxation under R.C. 5739.01(E)(1), as long as the owner of the aircraft is engaged in business." S.T. at 1-2. It appears that the

commissioner does not dispute that taxpayer, in the lease relationship created, furnished only the aircraft, via a dry lease, and, as such could potentially claim a sale-for-resale exception, but only so long as taxpayer was "engaged in business."

This board has previously considered the sale-for-resale exception in the context of the charter of a yacht by a company related to the yacht owner. In *The Barth Co. v. Tracy* (Aug. 26, 1994), BTA No. 1992-A-1014, unreported, this board determined that the owner of a luxury yacht, Barth, chartered the yacht to other entities in the same form as it had purchased it, i.e., without a crew, and, as such, it met the requirements for the sale-for-resale exception to sales tax. The commissioner argued "that this Board must employ a 'primary use test' when considering the 'resale' of the subject yacht, since it was often leased to an affiliated company, in what the Commissioner termed a 'less than arm's-length' transaction. The Commissioner argues that the transactions among the affiliated companies do not constitute 'resales' for purposes of R.C. 5739.01(E)(1), and thus, the primary use of the yacht was for appellant's own purposes, and not, as stated, for charter purposes." Id. In effect, the commissioner in *Barth*, as he has here, asked the board to disregard the separate corporate existence of Barth, as related to its affiliated charterers, so as to find that in fact, "the subsidiary was formed for the purpose of perpetrating a fraud and that domination by the parent corporation over its subsidiary was exercised [so] as to defraud complainant." Id., quoting *North v. Higbee Co.*, 131 Ohio St. 507 (1936), syllabus.

As this board recognized in *Barth*, "[c]ourts have been reluctant to disregard the corporate entity and have done so only where the corporation has been used as a cloak for fraud or illegality *or where the sole owner exercised such excessive control over the corporation that it no longer has a separate existence*. *** It has also been stated that the corporate entity should be disregarded only when justice cannot be served in any other way. ***." (Emphasis added.) *Barth*, supra, quoting *E.S. Preston Assoc., Inc. v. Preston*, 24 Ohio St.3d 7, 11 (1986). In *Barth*, this board considered that Barth chartered the subject yacht virtually the same number of days per year to its affiliate(s), as it did to third parties, and charged the same rates to its affiliates as it did to third parties. Further, Barth maintained separate books from its affiliates, and did not share profits gained through the charters of the yacht with its affiliates. Finally, Barth, the titled owner of the yacht, reported the yacht for federal income tax/regulatory purposes. Id.

Thus, we must look to the record before us to determine the nature of the relationship between taxpayer and Mitchell's, the primary/only lessee of the aircraft. Upon this board's review of the provisions of the "Non-Exclusive Aircraft Lease Agreement" entered into by taxpayer and Mitchell's, we agree with the commissioner that such lease "lacked both factual and economic substance." Tax Comm. Brief at 1. There is no defined lease term; each lease period "commences with delivery of the Aircraft to Lessee and concludes with the return of the Aircraft to Lessor." S.T. at 442. The subject "Aircraft is leased to Lessee on a non-exclusive basis and may be subject to use by Lessor, and/or to additional non-exclusive leases to other parties during the Term." S.T. at 442. The "Lessor may approve or deny any flight-scheduling request in Lessor's sole discretion," S.T. at 442, because the lease "does not confer upon Lessee any recurring or continuous right to use the Aircraft." S.T. at 443. The aircraft was leased to lessee at an hourly rate of $80.00, but Mitchell's was responsible for the costs of operating the aircraft, including, for example, fuel, maintenance service plans, storage, insurance, and retention of qualified mechanics and pilot services. S.T. at 4, 200, 419-421, 424. Finally, the lease was signed by Ms. Schmidt on behalf of both the lessor and the lessee.

Most telling of the foregoing lease considerations is that Ms. Schmidt signed on behalf of both the lessor and the lessee in the purported lease transaction between taxpayer and Mitchell's. Because Ms. Schmidt acted in such a dual capacity, the arm's-length nature of the transaction is called into question, specifically, whether the terms of the lease were negotiated and in whose interests Ms. Schmidt was acting. Further, the non-exclusive lease terms and the taxpayer's reservation of right to deny any flight scheduling request, for example, are only feasible between two entities that are, practically speaking, one and the same, i.e., "although the lease gives the lessee no defined right to use the aircraft, the lease places full responsibility for all the costs of operating and storing the aircraft on the lessee." S.T. at 4.

Outside of the lease terms, we find other indicia that taxpayer and Mitchell's are, in effect, one operation. Taxpayer's address is the residential address for Ms. Schmidt; taxpayer has no reported business location, out of which it operates, other than apparently Ms. Schmidt's home. Although taxpayer contends that the subject aircraft "is maintained in a visible hangar location and leased from the hangar," there is nothing in the record to indicate that any business is conducted out of that location. Flight logs indicate that all flights taken during the audit period were taken by Mitchell's, with no use by any third-party lessee. In fact, the record fails to demonstrate any desire or attempt to lease the subject aircraft to "others." Taxpayer does not engage in advertising the availability of its aircraft for lease; while advertising is not the only indicator of a legitimate business purpose, its lack thereof, in combination with taxpayer's lack of business location, causes this board to question the intent behind taxpayer's formation. Moreover, the loan for the purchase of the subject aircraft was signed by Ms. Schmidt in her individual capacity, as opposed to any type of representative capacity on behalf of taxpayer.

Based upon the foregoing, this board concludes that taxpayer did not purchase the subject aircraft for purposes of leasing it to others, as part of a business enterprise. On the contrary, appellant's position is belied by the record, as recounted herein. In fact, we find no evidence to support appellant's contentions and we conclude that the purchase of the subject aircraft and ensuing lease transactions between taxpayer and Mitchell's, its sole member, constitute "transactions without economic substance because there is no business purpose or expectation of profit other than obtaining tax benefits." R.C. 5703.56(A)(1). As the commissioner concluded, "[t]here is no separation between these entities and actors." S.T. at 5.

Taxpayer contends that it was engaged in a legitimate business, i.e., leasing operation, separate and apart from Mitchell's, for several reasons, including but not limited to its ability to limit taxpayer's liability, its ability to protect the privacy of a lessee, like Mitchell's, due to public availability of information regarding the taxpayer's use of the aircraft, and the taxpayer's ability, under the dry lease provisions, to incur less financial/administrative burdens. Brief at 11. While we acknowledge taxpayer's stated considerations, we do not agree that they establish a legitimate business purpose in taxpayer; on the contrary, they reinforce taxpayer's sole basis for existence, to lease the aircraft, but only to one lessee, Mitchell's, the sole member of taxpayer. While taxpayer claims that Mitchell's, which only has salon locations in Ohio, has a need for the aircraft for assignments outside of Ohio, we find no evidence in the record to support such claim. Thus, taxpayer has failed to provide the necessary evidence to support its position herein.

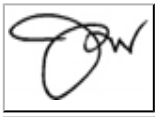
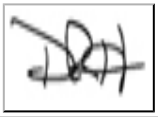
With regard to taxpayer's alternative argument that if the assessment is affirmed, the assessed penalties should be abated "because The Company made diligent efforts to comply with Ohio law, and acted in good faith and with reasonable cause in claiming the resale exemption," Taxpayer Brief at 16, we look to the court's pronouncement in *Jennings & Churella Constr. Co. v. Lindley*, 10 Ohio St.3d 67 (1984), wherein it held that "[r]emission of the penalty is discretionary. *** Appellate review of this discretionary power is limited to a determination of whether an abuse has occurred. ***" Id. at 70. Further, in *Huffman v. Hair Surgeon, Inc.*, 19 Ohio St.3d 83 (1985), the court held "'"In order to have an 'abuse' in reaching such determination, the result must be so palpably and grossly violative of fact and logic that it evidences not the exercise of will but perversity of will, not the exercise of judgment but defiance thereof, not the exercise of reason but rather of passion or bias. ***"' *State v. Jenkins* (1984), 15 Ohio St.3d 164, 222." Id. at 87. See, also, *J.M. Smucker, L.L.C. v. Levin,* 113 Ohio St.3d 337, 2007-Ohio-2073, ¶16. "[G]ood-faith efforts at compliance are not sufficient to show an abuse of the commissioner's discretion." *Kings Entertainment Company v. Limbach*, 63 Ohio St.3d 369, 371 (1992). In this instance, taxpayer has failed to carry its burden and provide any evidence or testimony to this board to support its position that it is deserving of an abatement of the penalties assessed; in fact, based upon the commissioner's conclusion, and this board's agreement, that taxpayer perpetrated a sham transaction, we are constrained to conclude that taxpayer did not demonstrate any good faith or reasonable cause relating to its claimed exemption.

Finally, with regard to issues raised regarding sales tax paid by taxpayer on lease payments for the subject aircraft, the only assessment under consideration in the instant appeal is a use tax assessment relating to the

purchase of the subject aircraft. Accordingly, we have no jurisdiction to address issues unrelated to such use tax assessment and/or the application of sales tax payments previously made to a use tax liability.

As this board has held, "[w]e will not engage in reweighing of evidence ***. *** After having been advised by the commissioner [through the final determination] that *** [appellant's] evidence was 'not sufficient' ***, appellant did not avail *** [itself] of the further opportunity to present [competent, probative] evidence on appeal before this board." *Gifford, Adams County Auditor v. Levin* (Apr. 8, 2014), BTA Nos. 2010-716-718, 2010-807-805, unreported. For example, taxpayer had the opportunity to bring competent, probative evidence to dispute the commissioner's finding of a sham transaction(s), but instead, waived hearing and relied upon its written argument. As this board held in *Ace Doran Hauling & Rigging Co. v. Tracy* (Sept. 30, 1994), BTA No. 1992-R-213, unreported, one consideration when determining whether intercompany rental payments are taxable is "was there testimony or other evidence that these transactions had substance, or were they merely instituted for accounting purposes?" In this instance, there was no testimony or evidence presented to dispute the commissioner's conclusions in the final determination regarding the nature of the lease transactions.

The burden is on appellant to establish its entitlement to any exception to the assessed tax through competent, probative evidence. When no evidence is offered to demonstrate that the Tax Commissioner's findings are incorrect, the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Kern*, supra; *Kroger Co. v. Limbach*, 53 Ohio St.3d 245 (1990); *Alcan*, supra. We conclude that appellant has failed to rebut the presumption that the findings of the Tax Commissioner are valid. *Alcan*, supra. Therefore, it is the decision of the Board of Tax Appeals that the final determination of the Tax Commissioner must be, and hereby is, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.

Kathleen M. Crowley, Board Secretary