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State and Local Tax Alert: When 'Pi in the Sky' is Too Good to be True: Ohio Sales Tax and Aircraft Leasing

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Last week, the Ohio Supreme Court issued a second sales tax decision involving the sale-for-resale exemption in as many weeks. Just before Thanksgiving Day, the Court issued a decision exempting purchases of bobblehead souvenirs by a professional sports team to be “given away” to game ticket purchasers. The Court concluded that the souvenirs were for resale by the team and thus, exempt from sales tax. We wrote about that case in our [November 26, 2018 State and Local Tax Alert](#). In the most recent decision, the Court addressed the purchase of an airplane and rejected the taxpayer’s claim of sale-for-resale. The case is styled *Pi in the Sky, LLC v. Testa*, Slip Op. No. 2018-Ohio-4812 (December 7, 2018).

The facts in *Pi in the Sky* were completely unsuited to support a resale claim. They were so one-sided that the Tax Commissioner argued that the alleged resale was a sham. Although the Court ruled in favor of the Tax Commissioner, it did not rule directly on the sham argument. Still, the Court ruled against the taxpayer and sent a message that “resales” too good to be true won’t be tolerated.

The taxpayer was a single member LLC owned by a C-corporation which, in turn, was owned and controlled by an individual who we will refer to as Ms. X. The LLC was formed to hold an aircraft for dry lease and, in fact, engaged in no other activity. Ms. X was president of the corporation and a licensed pilot. The LLC purchased the aircraft for \$1.2 million. Ms. X signed the purchase agreement for the LLC. Ms. X obtained a personal loan to fund the aircraft purchase with the LLC providing a commercial guaranty to the bank. The purchase agreement itself addressed sales tax matters only by indicating that the purchase was “out of state”.

The lease agreement was between the LLC as lessor and the corporation as lessee. The corporation operated several hair salons and day spas in the Cincinnati area. Ms. X signed the lease for both parties. The lease granted the corporation the non-exclusive use of the aircraft, required the lessee to provide and pay for operating, maintenance and storage costs as well as to pay the rental rate of \$80 per flight hour.

There was evidence presented that raised doubt whether the hourly rental charges actually were paid and whether sales tax was charged and remitted on those amounts. The monthly loan service was nearly \$6,500, making profitable operation at a rental rate of \$80 per hour nearly impossible.

The flight logs established that there was only one lessee, the corporation. The flight log also established 29 flights to and from an airport near the lakefront home of Ms. X which supported a conclusion of a personal use of the aircraft. Another 43 flights showed zero passengers with Ms. X as the pilot.

On these facts, the Ohio Board of Tax Appeals (BTA) concluded that the LLC did not purchase the aircraft for the purpose of leasing it to others as a part of engaging in business. Remember, one of the required elements for claiming the resale exemption under Ohio law is that the reseller be “engaged in business”. That term is defined by statute as an activity with the object of gain, benefit or advantage, either direct or indirect. Ohio Rev. Code 5739.01(F).

The LLC argued that its ownership structure and the leasing arrangement were designed to protect the privacy of passengers from publicly available flight data and to lessen the financial and administrative burdens of aircraft ownership. The Court was unpersuaded because no evidence was presented and the reasons offered did not necessarily bear on a gain, benefit or advantage derived from the leasing activity itself. The Court concluded that such a reason bears more on why the LLC was created rather than any gain, benefit or advantage derived from leasing. This is an important point. The Court seemed to be looking for evidence of benefit, gain or advantage that was derived from the lease itself. The bare idea that the arrangement protected the privacy of lessees and passengers was rejected given that there was only one lessee involved, and that corporate lessee was owned by the person who also owned the entire enterprise. In other words, the LLC lost its case when it failed to proffer evidence of a legitimate business purpose cast in terms of business profit, gain or advantage. On this point, the Court mentioned that the LLC failed to present evidence of a fair market value for the lease rate. Such evidence would have gone a long way toward making the taxpayer’s argument successful in the eyes of the Court. But, at \$80 per flight hour, there was no hope to establish that fact. The LLC’s failure to even try illustrates the factual “house of cards” around which it constructed its legal argument. In the end, the house collapsed and the Court’s 7-0 vote against the LLC was easily predictable.

The Court reached the correct decision. There is a saying that “bad facts make bad law” and this case presented very bad facts. But, the decision that followed was not the bad law we sometimes see. The Court’s decision was measured and instructive. The upshot of the decision is that lease arrangements between affiliated entities and related owners are not outside the coverage of the sale-for-resale exemption. A broad range of legitimate business purposes should be considered and incorporated into the lease terms. Matters such as risk management, insurance, capitalization and compliance with FAA requirements could all play in the mix. Importantly, if the rental rate is too good to be true (*i.e.*, what a reasonable range of rent in the marketplace would support), then the resale exemption is in jeopardy.

Vorys regularly advises clients in the area of sales tax and resale tax planning (regarding aircraft or other types of property and services) and we defend clients against tax assessments when the circumstances warrant. If you would like to discuss any particular facts or have us review transactional documents regarding the sale-for-resale exemption, please contact us.