OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18063380
	) CDTFA Acct. No. 100-540666
SNA AIRCRAFT SALES, LTD	) CDTFA Case ID 799120
	)
	) Date Issued: October 30, 2019
	)

OPINION

Representing the Parties:

For Appellant:	Lisa Nelson, Attorney
For Respondent:	Amanda Jacobs, Tax Counsel
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, SNA Aircraft Sales, LTD (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) issued on January 28, 2014. The NOD is for $409,769.17 in tax, a negligence penalty of $40,976.93, plus applicable interest, for the period July 1, 2006, through June 30, 2009. This matter is being decided based on the written record because appellant waived the right to an oral hearing.

ISSUES

1. Whether appellant established that an adjustment to the measure of unreported taxable sales is warranted for allegedly exempt sales.
2. Whether appellant established error with the audited measure of unreported aircraft rental income.
3. Whether the understatement was due to negligence.

[1] Sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

FACTUAL FINDINGS

1. Appellant was an aircraft retailer operating in Chino, California, from September 15, 2004, through September 30, 2012, when it terminated its business operations.
2. CDTFA audited appellant for the period July 1, 2006, through June 30, 2009 (audit period).
3. Appellant recorded total sales of $10,003,421, representing the sale of 18 aircraft, during the audit period.
4. Appellant reported gross receipts of $9,051,460 on its federal income tax returns (FITR's) for 2007 and 2008. During this same period, appellant recorded aircraft sales of $8,121,421.
5. Appellant only reported total sales of $1,820,160 on its sales and use tax returns (SUTR's) for the audit period. Appellant deducted 100 percent of its reported total sales as exempt sales in interstate commerce. Appellant provided CDTFA with FITR's for 2006, 2007 and 2008, some bills of sale and registration documentation, and incomplete flight data for some of its sales, to support the claimed exempt aircraft sales.[2]
6. On audit, CDTFA accepted five of the 18 sales as exempt. CDTFA regarded the remaining 13 sales as taxable, resulting in an audited measure of $4,078,921 for unreported taxable aircraft sales (the first audit item, issue 1).
7. Based on its review of appellant's FITR's, CDTFA determined that appellant also collected rental receipts from leasing aircraft. CDTFA determined that appellant failed to report $278,384 in taxable aircraft rental income (the second audit item, issue 2).
8. Appellant's reported income of $9,051,460 on its FITR's for 2007 and 2008 exceeds appellant's recorded aircraft sales of $8,121,421 for the same period. Appellant was unable to explain the difference of $930,039, and CDTFA regarded the entire amount as taxable sales, resulting in an audited measure of $930,039 for additional unreported taxable sales (the third audit item).
9. On January 28, 2014, CDTFA issued an NOD for tax of $409,769.17, a negligence penalty of $40,976.93, and applicable interest, for the underreporting disclosed by audit.

[2] The incomplete flight data was printed from FlightAware, a website offering free flight tracking information for private and commercial aircraft. (See < www.flightaware.com >.)

10. On February 26, 2014, appellant timely petitioned the NOD.
11. In a Decision issued on May 31, 2018, CDTFA denied the petition.
12. This timely appeal followed. On appeal, appellant concedes that the $930,039 asserted by CDTFA in the third audit item is taxable. Petitioner disputes the remainder of the liability as determined.

DISCUSSION

Issue 1. Whether adjustments to the measure of unreported taxable sales are warranted for allegedly exempt sales.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6012.) All of a retailer's gross receipts are presumed subject to tax until the contrary is established. (R&TC, § 6091.) Thus, absent an exemption, "sales tax applies when the property is delivered to the purchaser or the purchaser's representative in this state, whether or not the disclosed or undisclosed intention of the purchaser is to transport the property to a point outside this state, and whether or not the property is actually so transported." (Cal. Code Regs., tit. 18, § (Regulation) 1620(a)(3)(A).) All of a retailer's gross receipts are presumed subject to tax until the contrary is established. (R&TC, § 6091.)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Michael E. Myers* (2001-SBE-001) 2001 WL 37126924.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *ibid*; see also *Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.)

For the audit period, appellant recorded $10,003,421 in total sales. Nevertheless, appellant only reported $1,820,160 in total sales and $0 in taxable sales. On audit, CDTFA did

not dispute that $5,924,500 of the recorded aircraft sales are nontaxable. CDTFA included $4,078,921 of the recorded aircraft sales (representing 13 sales) in the NOD due to lack of documentation to support an exemption or exclusion. Considering that the audited unreported taxable measure of $4,078,921 represents aircraft sales that appellant recorded in its own records, we conclude that CDTFA met its initial burden to show that the NOD is reasonable and rational, and as such, the burden is on appellant to show otherwise.

Here, appellant contends that the exemption must be allowed for all of the transactions because the documentation it provided for the 13 disallowed transactions is substantially the same as the documentation provided for the 5 allowed transactions.[3] We must emphasize here that our inquiry is limited to the 13 disputed transactions before OTA, and we must correctly apply the law to the disputed transactions. The five accepted transactions are not at issue. Whether or not CDTFA followed its own internal policies, or previously allowed similar transactions in this audit, is simply not a relevant factor for us to take into consideration in deciding this appeal. Furthermore, although appellant argues that it provided the same type of documentation for all transactions at issue, the *type* of documentation provided (e.g., bill of sale) does not conclusively establish entitlement to an exemption or exclusion.[4] Instead, in determining the application of tax we must review the documentation and apply the statute authorizing an exemption or exclusion to the specific facts for each transaction.

[3] Appellant and CDTFA addressed the 13 transactions in a different order (see below). For ease of reference, we will use the numbers assigned to them by appellant in its opening brief.

Item number (Appellant)	Item number (CDTFA)	Tail number
1	3	N1768E
2	4	N20167
3	5	N4458S
4	6	N441MT
5	12	N997CW
6	15	N69604
7	1	N163N
8	8	N4721A
9	10	N3515L
10	13	N7280R
11	9	N759ZH
12	2	N87WS
13	18	N8167K

[4] For example, it appears CDTFA accepted three of the transactions as nontaxable sales for *resale* because the purchaser was a registered aircraft dealer, and a fourth CDTFA accepted as a nontaxable *out-of-state sale* because the contract required delivery outside this state.

Failure to timely obtain an exemption certificate (item 2, N20167; item 3, N4458S; item 7, N163N; item 8, N4721A; item 9, N3515L; item 10, N7280R; item 11, N759ZH; item 12, N87WS; and item 13, N8167K)

The law provides for an exemption from tax for the sale of aircraft to any person who is a non-resident of this state and who will not use the aircraft in this state, other than to remove the aircraft from this state. (R&TC, § 6366(a)(1); Cal. Code Regs., tit. 18, § 1593(b)(1)(C).) A non-resident will be considered as not using an aircraft other than to remove the aircraft from California if the aircraft is promptly removed from this state and is not returned to California within 12 months after its removal. (Cal. Code Regs., tit. 18, § 1593(c)(3).)

A seller may rebut the presumption that the sale of an aircraft is subject to tax by providing sufficient evidence to establish that tax is inapplicable, or by timely obtaining an exemption certificate from the purchaser. (Cal. Code Regs., tit. 18, § 1593(e).) The exemption certificate shall relieve the seller from liability for the tax only if it is taken timely and in good faith. (Cal. Code Regs., tit. 18, § 1593(e).) An exemption certificate will generally be considered timely if it is given at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or any time at or prior to delivery of the property to the purchaser. (Cal. Code Regs., tit. 18, § 1667(b)(1).) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

For these nine transactions, appellant provided no evidence or argument that the purchaser was a registered aircraft dealer purchasing the aircraft for nontaxable purposes of resale, or that the sale occurred outside this state. To the contrary, appellant argues that these sales are exempt from tax because the aircraft were sold to individuals (or businesses) who were not residents of California and who flew the aircraft out of California promptly after purchasing them and did not bring the aircraft into California during the 12-month test period. For all nine of these sales, appellant failed to timely obtain an exemption certificate from the purchaser.[5] Furthermore, appellant failed to provide complete flight data to show that the aircraft did not return to California during the first 12 months (and, for many of the transactions, appellant failed to provide data to show the aircraft were promptly removed from this state). For each of these

[5] Appellant did obtain exemption certificates for item 7 (NI63N) and item 8 (N4721A); however, both were untimely because they were signed in 2010, while the sales were in 2006 and 2007, respectively.

nine transactions, appellant contends that the exemption is allowable because there is no evidence demonstrating that the aircraft returned to California during the 12-month test period. Here, appellant is attempting to reverse the statutory presumption that tax applies until the contrary is established. (R&TC, § 6091.)

CDTFA does not bear the burden of establishing that appellant's gross receipts from the retail sale of aircraft are taxable. (R&TC, § 6091.) Rather, appellant bears the burden to prove, with documentation such as flight logs, expense receipts showing the location of the aircraft, or similar corroborating evidence, that the aircraft was promptly removed from this state and remained outside California for 12 months after its removal. (See *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443.) Appellant has not done so for any of these nine sales. Accordingly, we find that appellant has not provided sufficient evidence to rebut the presumption that these nine sales are subject to tax.

Item 1 (N1768E)

For this transaction, according to the Bill of Sale, appellant sold the aircraft to Sagewind LLC, a Wyoming company, on October 2, 2006. The sale was registered to the LLC at a Wyoming address; the Certificate of Registration was recorded on November 29, 2006. Appellant notes that the purchaser, who was not a California resident, financed the purchase through a Wyoming bank. Appellant also observes that the available (incomplete) flight data, from December 19, 2006, through December 4, 2007, does not reflect any California flights. Accordingly, appellant contends that the aircraft was sold to a non-resident of California who promptly flew the aircraft to an out-of-state location and then did not return the aircraft to California for 12 months following its removal from the state.

Here, first, there is no evidence of a flight from California to Wyoming to promptly remove the aircraft from this state following the sale on October 2, 2006. The available flight data begins with a flight in Wyoming on December 19, 2006, more than 2 months after the sale. There is no flight data for the period from October 2, 2006, through December 19, 2006. Thus, there is no evidence that the aircraft was promptly flown to an out-of-state location, and there is insufficient evidence to establish that the aircraft was kept outside this state for a full 12 months following the date of its removal. Therefore, we find that appellant has not provided evidence sufficient to rebut the presumption that the sale was subject to tax.

Item 4 (N441MT)

For this transaction, according to the Aircraft Bill of Sale, appellant sold the aircraft on May 18, 2007, to Southern Cross Aviation, Inc., of Camarillo, California (Southern Cross). Appellant contends that the escrow agent erroneously listed the wrong person as the purchaser, and the actual purchaser was Douglas Aircraft Party Limited, from Ashmore, Queensland Australia, a non-resident of California. In support, appellant submitted a "Set Aside Statement," written in memo form to "FAA Aircraft Registration Branch" and dated July 14, 2011.[6] That statement says that the parties (appellant and Southern Cross Aviation, Inc.) "hereby set-aside the aircraft Bill of Sale date [*sic*] May 18, 2007 . . . . The sale was not consummated." The alleged purchaser's name is not listed on any of appellant's documents. On the Application for Export Certificate Airworthiness dated June 4, 2007, the name of the purchaser is listed as Rossair Charter Pty Ltd, with an address in South Australia.

Appellant has not adequately documented that appellant sold the aircraft at retail, in this state, to any party other than Southern Cross Aviation, a California resident.[7] Moreover, the available flight data shows a flight from Long Beach California to Grand Junction, Colorado on May 24, 2007, and a flight from Grand Junction to Camarillo, California on June 12, 2007. Accordingly, even if we assumed, *arguendo*, that the purchaser was a non-resident of California, the evidence shows that the aircraft re-entered California during the 12-month period following its removal, which is sufficient to disqualify this transaction from the exemption claimed. (Cal. Code Regs., tit. 18, § 1593(c)(3).) Therefore, we find that appellant has not provided evidence sufficient to rebut the presumption that the sale was subject to tax.

Item 5 (N997CW)

For this transaction, the Bill of Sale indicates that appellant sold the aircraft to Dorothea Danesy, a resident of Texas, on August 21, 2008. The available flight data shows that on September 11, 2008, the aircraft flew from Santa Ana, California to an airport identified only as

[6] There is no evidence that the set-aside statement was accepted by or delivered to the Federal Aviation Administration (FAA).

[7] Furthermore, there is insufficient evidence to conclude that this is an exempt sale in foreign commerce because the purchase agreement indicated delivery directly to a California resident purchaser. (See Cal. Code Regs., tit. 18, § 1620(a)(3)(C)2.)

SBP[8] and from an airport shown as SCI to an airport shown as RZS, then from an airport shown as VTU back to SBP. There is no explanation in the record for the fact that, for two of these flights, the aircraft is shown to depart from an airport different from the one where it purportedly had just landed. On September 12, 2008, the aircraft made additional flights within California. According to appellant, the aircraft remained in California for a short period after the sale for the purpose of having special equipment installed which was necessary for the aircraft to be flown to Germany. Appellant asserts that the time in California falls within the parameters of Regulation 1593(d), which states that the exemption for the sale of an aircraft to a non-resident of California for prompt removal from this state will not be affected if the aircraft is returned to California within the 12-month period solely for repair or service covered by warranty. Appellant contends that, after the equipment was installed, the aircraft was disassembled by an export company, placed into a container and shipped to Germany out of the Port of Oakland. As evidence, appellant provided a picture of what appears to be the aircraft in Germany in July 2010 (approximately 2 years after the date of sale) to support its contention the sale was an exempt sale in interstate commerce.

Regarding this transaction, CDTFA contends that appellant has provided no evidence that the aircraft was irrevocably committed to the exportation process at the time of sale, such as a bill of lading or other documentation showing that the aircraft was delivered to a carrier for subsequent delivery to the purchaser in Germany.

The law allows for an exemption from sales tax for sales in interstate commerce. (R&TC, § 6352; Cal. Code Regs., tit. 18, § 1620(a)(3).) In order to qualify as an exempt sale in interstate commerce, the law provides:

> Sales tax does not apply when the property pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer, by means of:
>
> 1. Facilities operated by the retailer, or
>
> 2. Delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point.

[8] The airport "SBP" and the other airports for which the letters are used throughout discussion for this transaction were not identified in the record. However, each of the flights made on September 11 and 12, 2008 were 20 minutes or less. Thus, it is clear that all the airports were in California.

(Cal. Code Regs., tit. 18, § 1620(a)(3)(B).) "Bills of lading or other documentary evidence of the delivery of the property to a carrier, customs broker, or forwarding agent for shipment outside this state must be retained by the retailer to support deductions taken" for all claimed exempt sales in interstate commerce. (Cal. Code Regs., tit. 18, § 1620(a)(3)(D).)

With respect to exports, sales tax does not apply when the property is sold to a purchaser for shipment abroad and is shipped or delivered by the retailer to the foreign country. (Cal. Code Regs., tit. 18, § 1620(a)(3)(C)2.) In order for the sale to be exempt as an export, the property must (1) be intended for a destination in a foreign country, (2) be irrevocably committed to the exportation process at the time of sale, and (3) actually be delivered to the foreign country prior to any use of the property. (*Ibid.*) Movement of the property into the process of exportation does not begin until the property has been shipped, or entered with a common carrier for transportation to another country, or has been started upon a continuous route or journey which constitutes the final and certain movement of the property to its foreign destination. (*Ibid.*) As relevant here, there has been an irrevocable commitment of the property to the exportation process when the property is sold to a purchaser for shipment abroad and is shipped or delivered by the retailer in a continuous route or journey to the foreign country by means of a carrier, forwarding agent, export packer, customs broker or other person engaged in the business of preparing property for export, or arranging its export. (*Ibid.*)

First, the transaction does not qualify for the exemption for sales to non-residents for use outside this state, because appellant failed to provide evidence showing the aircraft was promptly removed from this state and remained outside this state during the entirety of the 12-month test period, and the available evidence shows that the aircraft was stored or flown within this state for the first few weeks after the date of purchase. Although appellant contends that the aircraft was flown and maintained in California for qualifying repair work, appellant bears the burden of establishing entitlement to this exemption. Here, appellant provided no documentation to corroborate the reason for the in-state flights.

Second, the transaction does not qualify as an exempt sale in foreign commerce because appellant failed to provide evidence that the aircraft was irrevocably committed to the exportation process at the time of sale. To the contrary, the property was delivered to the purchaser in California and, although appellant contends it ultimately ended up in Germany two years after the sale, CDTFA provided United States Department of Transportation, Federal

Aviation Administration documents, signed by the purchaser, proving that the purchaser registered the aircraft using an El Paso, Texas mailing address on September 8, 2008, and re-registered it using the same address on September 5, 2012, more than two years after the aircraft appears to have been photographed in Germany.

Third, the transaction does not qualify as an exempt sale in interstate commerce because the aircraft was delivered to the purchaser in this state. (Cal. Code Regs., tit. 18, § 1620(a)(3)(A).)

Item number 6 (N69604)

For this transaction, according to an Aircraft Letter of Acceptance dated September 18, 2007, Rich Pala was acting "on behalf of the buyers as their agent" in the purchase of the aircraft. The purchaser is not named, but the signature of the buyer appears to spell "Szafranek" (discussed further, below). The available evidence includes an undated Bill of Sale, which was recorded with the FAA on December 28, 2007, documenting a sale from appellant to Christopher Pala[9] and listing Mr. Pala's address as a location in Sagamore Hills, Ohio. On December 28, 2007, a temporary certificate of registration, with an expiration date of January 27, 2008, was issued to Christopher Pala, as an individual owner. A Bill of Sale dated on or around[10] January 14, 2008, documents a sale from Christopher Pala to Michal Szafranek in Germany.

Appellant contends that Mr. Pala was acting as an agent for Mr. Szafranek, a non-resident of California, and that the aircraft was promptly flown out of California and not returned to California during the 12-month test period. Appellant acknowledges that the aircraft did remain in California for a period, but states that it was flown in California only for the limited purpose of maintenance. Appellant further states that the aircraft's departure from California was delayed due to window replacements. The only evidence appellant has provided to support its assertion that the aircraft was in California for repairs is one invoice from Howard Aviation in LaVerne, California, dated December 7, 2007 (almost three months after the Aircraft Letter of Acceptance), for an avionics upgrade.

[9] As indicated above, the Aircraft Letter of Acceptance was signed by Rich Pala. Appellant states that Mr. Pala's first name was Christopher, but he used the nickname "Rich." We make no finding on this matter.

[10] The date is difficult to read and may be January 16, but that detail is immaterial.

Here, there appear to have been multiple sales and purchases of this aircraft. First, according to the undated Aircraft Bill of Sale recorded with the FAA on December 28, 2007, Mr. Pala reportedly purchased the aircraft from appellant. Next, there is a second Aircraft Bill of Sale dated January 14, 2008, reporting the sale of this aircraft from Mr. Pala to Mr. Szafranek.

The pertinent transaction for purposes of our inquiry is the sale from appellant to Mr. Pala, a non-resident of California. Appellant failed to provide evidence of a prompt flight of the aircraft to a location outside this state or evidence that the aircraft did not re-enter California within 12 months from the date it was removed from this state. To the contrary, the evidence shows that the aircraft was in California, and appellant's unsupported assertion that it was in California solely for qualifying repairs and updates is unpersuasive. First, the flight information shows a departure from Fullerton, California, on February 21, 2008, and an arrival at El Monte, California, on March 5, 2008. Second, there is no explanation for the flights or location of the aircraft during the period of almost two weeks (February 21 through March 5, 2008), which occurred two months after the December 28, 2007 Bill of Sale from appellant to Mr. Pala. Third, appellant has provided no documentation of repairs to the aircraft during the period February 21, 2008, through March 5, 2008. As such, we find that appellant failed to establish that the aircraft was promptly removed from California and remained outside California during the test period.

Furthermore, the transaction cannot qualify as an exempt sale in interstate or foreign commerce because it was delivered in this state directly to the purchaser identified in the sales agreement. Therefore, we find that appellant has not provided evidence sufficient to rebut the presumption that the sale was subject to tax.

Issue 2. Whether appellant established error with the audited measure of unreported aircraft rental income.

For purposes of the Sales and Use Tax Law, a taxable "sale" or "purchase" in this state includes any lease of tangible personal property in any manner or by any means whatsoever, for a consideration, except a lease of mobile transportation equipment. (R&TC, § 6006(g)(4); R&TC, § 6010(e)(4).) Mobile transportation equipment means equipment for use in transportation of persons or property over substantial distances and includes aircraft. (R&TC, 6023; Cal. Code Regs., tit. 18, § 1661(a)(1).)

With respect to leases of aircraft, the sale to the *lessor* is considered a taxable retail sale and the lessor is the consumer of the aircraft. (Cal. Code Regs., tit. 18, § 1661(b)(1).) Thus, either sales tax applies to the sale of aircraft to a lessor, or use tax applies on the lessor's use of the aircraft for leasing purposes in this state. (Cal. Code Regs., tit. 18, § 1661(b)(1).) If the use of aircraft purchased without tax and for purposes of resale is limited to leasing the aircraft, the purchaser may elect to report and pay its use tax liability on the fair rental value of the aircraft. (R&TC, § 6094(d).) Fair rental value generally means any rentals required under the lease. (Cal. Code Regs., tit. 18, § 1661(b)(2)(A).) Such election must be made on or before the due date of the return for the period in which the equipment is first leased, otherwise use tax is imposed on the lessor's entire purchase price for the aircraft. (R&TC, § 6094(d).) When a timely election to pay tax on the fair rental value of aircraft is made, use tax must thereafter be paid with the lessor's return for each reporting period, measured by fair rental value, regardless of whether or not the aircraft is located within this state. (Cal. Code Regs., tit. 18, §1661(b)(2).)

Here, appellant, an aircraft dealer, reported income from aircraft leases of $160,843, and miscellaneous income of $131,628, on its FITR's for calendar years 2006 through 2008. During the audit of appellant, CDTFA's auditor made three separate written requests (on 9/16/11, 12/26/12, and 6/28/13) for any documentary information to support the nature of the leases or which aircraft were leased, and appellant failed to provide any documentation. On appeal, appellant provided a letter from its insurance agent, stating that for the time period at issue, appellant's insurance policy only "provid[ed] coverage for various aircraft for the sale and demonstration of those aircraft … all uses were limited to sales and demonstration."

Here, even if we accept that leasing purposes would not have been covered by appellant's insurance, this fact by itself would not prove that appellant did not charge customers for the use of its aircraft. As one possible example, appellant could have maintained separate policies with separate providers. Nevertheless, we need not resolve this issue. The terms lease and demonstration are separately defined in the Sales and Use Tax Law, and definitions or general

usage of these terms by the aviation industry are not persuasive or even relevant.[11] Here, appellant reported receiving aircraft rental income on its FITR's, and appellant does not dispute that it received compensation from customers for aircraft "demonstration" flights. For sales and use tax purposes, a taxable use of mobile transportation equipment would include any rental, hire, and license of an aircraft for a consideration, even to a potential customer. (R&TC, §§ 6006.3, 6009.) Thus, such a taxable use would include receiving "demonstration" charges from customers in exchange for permitting the customer to fly the aircraft, even if only to help them decide whether or not to purchase the aircraft. (R&TC, § 6094(d).) Appellant has otherwise provided no documentation to establish that the $278,384 in "demonstration" charges it received for use of the aircraft were non-taxable, despite its obligation to maintain and provide complete and accurate records for audit. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Under R&TC section 6006 and Regulation 1661, tax applies to appellant's entire purchase price of the aircraft. Nevertheless, CDTFA only asserted tax on the rental stream. As such, CDTFA under-computed the liability. Therefore, we find no adjustments are warranted.

Issue 3. Whether the understatement was the result of negligence.

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination applies.

Taxpayers are required to maintain and make available for examination on request by CDTFA, or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the SUTR's. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax

[11] For example, under regulations promulgated by the FAA, certain aircraft operators, other than air common carriers, are permitted to charge prospective customers for aircraft demonstration flights and those charges may include listed expenses plus an additional markup of 100 percent. (14 C.F.R. § 91.501(b)(3).) We further note, for example, that the Federal Aviation Administration granted National Business Aviation Association Exemption 7897, which has been in existence since 1994, and extends the scope of this provision permitting charges for demonstration flights, to certain operators of small aircraft. (See < https://nbaa.org/press-releases/faa-extends-nbaas-small-aircraft-exemption-for-members/ >.)

returns. (Cal Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, is considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to determinations associated with the first audit of a taxpayer. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167 Cal.App.2d 318, 321-324.) However, a negligence penalty is appropriate in a first audit if the understatement cannot be attributed to a bona fide and reasonable belief that the bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (*Ibid*.)

CDTFA imposed a 10-percent negligence penalty because it concluded that appellant's books and records were incomplete and inadequate. CDTFA contends that appellant did not retain complete sales records, did not provide shipping or delivery records to support its claimed non-taxable sales, and failed to provide documentation regarding the substantial differences between amounts reported on FITR's and SUTR's. CDTFA also contends that appellant reported none of its sales as taxable, yet it did not retain complete documentation to support any exemptions claimed.

Appellant disputes the negligence penalty, asserting that CDTFA should adhere to its policy to not apply a negligence penalty in the first audit of a taxpayer. Further, appellant asserts that it was not aware that it needed to obtain an exemption certificate to support nontaxable sales, but that it did maintain and gather substantial records to support its assertion that its sales were not subject to tax.

Here, appellant claimed an exemption or exclusion for all of its sales, but did not retain adequate evidence to support the claimed deductions. Moreover, appellant reported total sales of only $1,820,160 for the audit period, while it had recorded 18 transactions totaling $10,003,421 for the same period. Further, for the two years 2007 and 2008, appellant reported an additional $930,039 in gross receipts in addition to the recorded sales of aircraft. Thus, appellant reported sales of at least $10,933,460[12] on its FITR's, and thus reported less than 17 percent

[12] Since the FITR's for 2006 and 2009 each encompass six months outside the audit period, it is not known whether appellant reported more on those FITR's than it did on SUTR's.

($1,820,160 ÷ $10,933,460) of its total sales on its SUTR's (and 0 percent of its taxable sales). Although appellant contends the $930,039 is the result of filing income tax returns on a calendar year basis, and SUTR's on a fiscal year basis, this fact has no relevance because the reported difference was based on comparing the $9,051,460 in income that appellant reported on its FITR's to an actual basis record of appellant's $8,121,421 in recorded aircraft sales for the exact same period covered by the FITR's. We find that appellant's failure to keep records and its egregious underreporting, with no reasonable explanations, are evidence that appellant did not have a bona fide and reasonable belief that its recordkeeping and reporting practices were sufficient for sales and use tax purposes. Therefore, we find that the understatement was the result of negligence, and the negligence penalty was properly applied.

HOLDINGS

1. Appellant failed to establish that any adjustments to the measure of unreported taxable sales are warranted for allegedly exempt sales.
2. Appellant failed to establish error with the audited measure of unreported aircraft rental income.
3. The underreporting was due to negligence.

DISPOSITION

Sustain CDTFA's decision to deny the petition for redetermination.

DocuSigned by:
3CADA62FB4864CB...
Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Michael F. Geary
1A9B52EF88AC4C7...
Michael F. Geary
Administrative Law Judge