OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18053161
	CDTFA Case ID: 949158
SNOWFLAKE FACTORY LLC	CDTFA Account No. 84-227155

OPINION

Representing the Parties:

For Appellant:	Andrew Matosich, LLC Manager
For Respondent:	Mengjun He, Tax Counsel III Lisa Renati, Hearing Representative Monica Silva, Tax Counsel IV
For Office of Tax Appeals:	Matthew Miller, Tax Counsel III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Snowflake Factory LLC (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 April 5, 2016. The NOD is for $95,000 in tax, plus accrued interest, and is based on CDTFA's determination that appellant purchased an aircraft in this state on January 27, 2015, for $1,000,000.

Administrative Law Judges Andrew J. Kwee, Teresa A. Stanley, and Daniel K. Cho held an oral hearing for this matter in Van Nuys, California, on October 29, 2019. At the conclusion of the oral hearing, OTA held the record open until December 24, 2019, at which time the record was closed, and this matter was submitted for a decision.

[1] Sales and use 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.

ISSUE

Whether California use tax applies to appellant's storage, use, or consumption of the aircraft.

FACTUAL FINDINGS

1. On August 25, 2011, appellant registered with the California Secretary of State as a California limited liability company.
2. On or about January 20, 2015, appellant became aware of a 1981 Cessna 441 aircraft with tail number N441X that was available for purchase (the aircraft). Fleet Planes, Inc. (Fleet), an Oregon aircraft broker, was selling the aircraft on behalf of its owner, MV Forger, Inc. (MVF), an Oregon corporation. Appellant's manager, Andrew Matosich, met with representatives for MVF and Fleet to discuss potential terms for the sale and purchase of the aircraft.
3. The aircraft was located at Landmark Aviation in Fresno, California, during a pre-purchase inspection performed at the request of appellant (as the purchaser) on January 21, 2015.[2]
4. During purchase negotiations, MVF conveyed to appellant that MVF needed to sell the aircraft by January 27, 2015, in order for an exchange to qualify for deferred recognition of gain pursuant to Internal Revenue Code (IRC) section 1031 (1031 exchange).[3]
5. Appellant, on the other hand, conveyed to MVF that "the Aircraft needed to be delivered to [appellant] in Oregon."[4]

[2] Appellant's LLC Manager, Andrew Matosich, submitted a declaration stating that appellant required a pre-purchase inspection as a condition of purchase. The parties thereafter added to the Aircraft Purchase Agreement a requirement that the seller pay for the costs of repairs disclosed during the pre-purchase inspection.

[3] As relevant, when a person purchases replacement property before selling the property to be exchanged (relinquished property), the person generally has 180 days to complete the sale of the relinquished property, otherwise the transaction will not qualify for deferred recognition of gain. (*Estate of George H. Bartell Jr. et al v. Commissioner* (2016) 147 T.C. 5; Rev. Proc. 2000-37, 2004-51.) This is generally referred to as a reverse 1031 exchange. The declaration from Jon Barnett indicated that MVF purchased a jet as the like-kind replacement property for the Cessna 441 aircraft.

[4] The record does not specify why appellant wanted the transaction to occur in Oregon. As relevant, however, Oregon does not impose a general sales/use tax. < www.oregon.gov/DOR/Pages/sales-tax.aspx >.

6. The work order for the pre-purchase inspection disclosed $16,351.93 in repairs that needed to be performed, including replacing a portion of the right wing. The work order indicated that repairs would take approximately 145.8 man-hours of labor to correct.

7. The parties determined that the corrective repairs could not be completed by January 27, 2015. Therefore, in order to satisfy the requirements of all parties, the parties attempted to structure the transaction as a sale from MVF to Fleet in California on January 27, 2015, followed by another sale from Fleet to appellant in Oregon at a later date. Fleet did not have sufficient funds to purchase the aircraft from MVF. Therefore, the parties agreed that appellant would transfer the entirety of the purchase price for the aircraft to Fleet in exchange for transfer of title to the aircraft to appellant by close of escrow. The purpose was to satisfy MVF's requirement to sell the aircraft by January 27, 2015.

8. On January 26, 2015, appellant and Fleet signed an Airplane Purchase Agreement for the sale of the aircraft to appellant for $1,000,000, subject to certain terms and conditions, including: (1) "Close must occur by end of day 27 January 2015"; (2) seller shall deliver the aircraft to appellant in Oregon; and (3) risk of loss passes to appellant upon delivery of the aircraft.

9. On January 27, 2015, the parties filed an Aircraft Bill of Sale (Form No. 8050-1) with the Federal Aviation Administration (FAA), identifying appellant as the purchaser, and Fleet as the seller.[5] The FAA Bill of Sale further states that the seller holds "full legal and beneficial title of the aircraft [and] does this 27 day of January, 2015, hereby sell, grant, transfer, and deliver all rights, title and interests in and to such aircraft unto [appellant]."

10. On January 28, 2015, appellant filed an Aircraft Registration Application with the FAA, identifying "Snowflake Factory, LLC" as the applicant. Andrew Matosich signed the Aircraft Registration Application on behalf of appellant, and dated his signature January 27, 2015. Appellant's January 28, 2015 FAA Aircraft Registration Application includes the following certification, which Andrew Matosich signed on behalf of appellant, as its LLC Manager, certifying that appellant owned the aircraft:

[5] On the day of the oral hearing, appellant submitted a letter dated October 23, 2019, on behalf of appellant and addressed to the FAA, attempting to change this date from January 27, 2015, to February 10, 2015. This document was not admitted into evidence because it was untimely, and will not be addressed further.

> A false or dishonest answer to any question in this application may be grounds for punishment by fine and/or imprisonment: (U.S. Code, Title 18, section 1001).
>
> CERTIFICATION
>
> I/We certify that the above aircraft is owned by the undersigned applicant . . . .

11. Appellant reported a California address on its Aircraft Registration Application and on the Bill of Sale, both of which it filed with the FAA.
12. Fleet, by and through its agent, Jon Barnett, delivered possession of (but not title to) the aircraft to appellant in Oregon on February 10, 2015.
13. On August 20, 2015, in support of a claimed exemption from tax, Andrew Matosich submitted a declaration signed under penalty of perjury to CDTFA, declaring that appellant took title to the aircraft in California:

> As the Aircraft Purchase Agreement States, solely for the convenience of the seller [appellant] took title to the aircraft while the Aircraft was still undergoing its post pre-inspection corrective work in Fresno, California, where it was still under the control of [Fleet.]

14. Both parties agree that the aircraft was located in California on January 27, 2015, and located in Oregon on February 10, 2015.
15. On April 5, 2016, CDTFA issued the NOD to appellant for $95,000 in use tax, plus applicable interest, for the purchase of the aircraft, which appellant timely petitioned.
16. On February 14, 2018, CDTFA denied the petition. This timely appeal followed.
17. On June 28, 2018, Andrew Matosich submitted a declaration signed under penalty of perjury, contending that appellant agreed to accept the "FAA Bill of Sale as a security instrument to secure repayment of the funds if the plane was rejected [by appellant], much like a bank holds title to a home under a mortgage."

DISCUSSION

The Date of Sale or Purchase of the Aircraft

As a preliminary matter, the parties dispute the date and location of the sale or purchase of the aircraft. The parties do, however, agree that the aircraft was located in California on January 27, 2015, and in Oregon on February 10, 2015, and that the sale and purchase occurred

on one of these two dates. For purposes of the sales and use tax law, the terms "sale" and "purchase" mean and include any transfer of title or possession, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. (R&TC, §§ 6006(a), 6010(a).)

Here, appellant submitted a declaration signed under penalty of perjury stating that title transferred while the plane was in California. In addition, according to the FAA Bill of Sale, appellant obtained "full legal and beneficial title of the aircraft," which appellant concedes was transferred as security in exchange for the $1,000,000 purchase price, which appellant paid no later than January 27, 2015. Finally, appellant filed a certification with the FAA on January 28, 2015 (and dated January 27, 2015), certifying, under penalty of perjury, that the "aircraft is owned by the undersigned applicant." Based on the above evidence, we find that appellant obtained title to the aircraft on January 27, 2015, in exchange for consideration of $1,000,000. As such, we conclude that appellant purchased the aircraft on January 27, 2015, in California.

Appellant contends that the sale did not occur until February 10, 2015, when appellant obtained possession of the aircraft. Appellant analogizes this to a bank retaining title to real property as security for payment of the mortgage. Nevertheless, the Sales and Use Tax Law provides that a sale or purchase includes any transfer of title *or* possession in lieu of a transfer of title, conditional or otherwise. (R&TC, §§ 6006(a), 6010(a) [emphasis added].) In simplest terms, if there is a transfer of title, there is a sale. (*Ibid*.) Furthermore, if there is a transfer of possession in lieu of title, there is a sale. (*Ibid*.) When both elements are met, the sale occurs upon the earlier of title transfer or transfer of possession in lieu of title. As such, appellant's argument that title was transferred as "security" for the $1,000,000 purchase price is unpersuasive, because the reason a seller transfers title to the purchaser (or, alternatively, retains title) is simply of no consequence under the Sales and Use Tax Law, which only requires a transfer of "title or possession" to constitute a sale, and irrespective of the seller's *intent*. (*Ibid*.) In cases where the seller retains title (whether as security or for any other purpose), then the element of "title" transfer is not met, and a sale will only occur if there has been a transfer of "possession." On the other hand, when title transfers before possession (whether as security or for any other purpose), then the element of title transfer is met, a sale has occurred, and the date or location of delivery is irrelevant. Thus, for example, when the seller retains title as security

for payment of the purchase price, the sale will occur as soon as the purchaser obtains possession of the property, even though title transfers at some later date (of course, if title transferred before possession, then the sale would occur on the date title transferred). (R&TC, §§ 6006(a), 6010(a); Cal. Code Regs., tit. 18, § 1628(b)(3)(A).) Here, appellant admittedly obtained title to the aircraft in California, prior to obtaining possession in Oregon. As such, we find that the sale occurred on January 27, 2015, the date of title transfer. Under such circumstances, both the reason appellant obtained title on January 27, 2015, and the location where appellant subsequently obtained possession, are irrelevant.

Separately, appellant refers to the delivery certificate as proof that the sale occurred in Oregon on February 10, 2015. Appellant also emphasizes that, pursuant to the Aircraft Purchase Agreement, risk of loss does not transfer until physical delivery. The law provides that "*[u]nless* explicitly agreed that *title* is to pass at a prior time, the sale occurs at the time and place at which the retailer completes [its] performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different [(i.e., later)] time or place." (Cal. Code Regs., tit. 18, § 1628(b)(3)(D) [emphasis added]; see also Cal. Comm. Code, § 2401(2).) Again, the key word here is "*unless*" title transfers earlier. The reason is because this regulation interprets R&TC sections 6006 and 6010, which provide that the sale and purchase occur at the earlier of the transfer of: title *or* possession (i.e., in lieu of title). Here, because title transferred on January 27, 2015, the seller's obligations regarding delivery and risk of loss are simply not relevant. In summary, based on our finding that title transfer occurred on January 27, 2015, the sale occurred on the date of title transfer, and the date of delivery, or risk of loss, is irrelevant.

Appellant also contends that the transaction was a sale on approval within the meaning of California Code of Regulations, title 18, section (Regulation) 1628(b)(3)(C) and, as such, the sale occurred on February 10, 2015. There is no further regulatory definition of what is meant by a sale on approval. As such, we may look to other areas of law, such as the California Uniform Commercial Code (UCC), for guidance.[6] (See, e.g., Sales and Use Tax Annotation 495.0130 [conditional sale vs. sales on approval].)[7] Under the UCC, a sale on approval contemplates a scenario where the sales contract gives the seller "a power … to turn

[6] The California Commercial Code may be cited as the Uniform Commercial Code. (Cal. U. Com. Code, § 1101.) California has largely adopted the Uniform Commercial Code. (See Cal. U. Com. Code, §§ 1101 to 1310.)

[7] CDTFA's annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.)

back the goods even though they are wholly as warranted." (Cal. U. Com. Code, § 2-326, Comment 2.) "The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver [them.]" (*Id*., at Comment 1.) Title and risk of loss generally transfer upon acceptance of the goods. (Cal. U. Com. Code, § 2-327.) Based on the above, for purposes of the Sales and Use Tax Law, we conclude that a sale on approval within the meaning of Regulation 1628(b)(3)(C) does not include property sold in "as-is" condition, or transactions where the purchaser's ability to reject the property is limited to issues involving a breach of contract.

Here, there is no evidence that appellant had an unconditional right to return the aircraft prior to February 10, 2015. To the contrary, the Aircraft Purchase Agreement specifies that the "aircraft is being sold 'as-is' with no warranty express or implied" other than to be free of liens and encumbrances. There is no provision in the purchase agreement that gives appellant the right to reject the aircraft, or to return the aircraft. Furthermore, the only condition precedent to appellant's payment of the purchase price, $1,000,000, was that the aircraft be inspected, which occurred on January 21, 2015. Appellant was required under the agreement to wire, and did wire, the purchase price, $1,000,000, upon completion of the pre-purchase inspection so that close of escrow could occur by January 27, 2015. Close of escrow was thereafter completed on January 27, 2015, and appellant promptly filed an aircraft bill of sale with FAA on January 27, 2015, and an application to register the aircraft with FAA on January 28, 2015, and certified on the application that appellant was the owner of the aircraft. Therefore, we find insufficient evidence that appellant had a right to return the aircraft for any reason prior to February 10, 2015. To the contrary, we find that the aircraft was sold "as-is" to appellant on January 27, 2015. As such, we find that appellant failed to establish it purchased the aircraft in Oregon pursuant to a sale on approval, as defined in Regulation 1628.

In summary, we find that appellant purchased the aircraft in California on January 27, 2015, the date that appellant obtained title to the aircraft.

The Sales Tax

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.) The sale of an aircraft is exempt from sales tax when the retailer is other than a person required to hold a California seller's permit by reason of the number, scope,

and character of the person's sales of aircraft in this state. (R&TC, § 6283(a); Cal. Code Regs., tit. 18, § 1610(b)(1)(C).) In the instant case, there is no evidence that Fleet held a California seller's permit or that it made any other sales in this state aside from the single sale of the aircraft to appellant, or that it had an office or other place of business in this state. Furthermore, the parties both argue that the transaction is exempt from sales tax.[8] In summary, we find that sales tax is inapplicable.[9]

The Use Tax

When sales tax does not apply, such as when an in-state sale is exempt from sales tax or the sale occurs outside this state, use tax is imposed on the sales price of property purchased from a retailer for the storage, use, or other consumption of property inside this state. (R&TC, §§ 6201, 6401.) The use tax is imposed on the person storing, using, or otherwise consuming the property. (R&TC, § 6202.) When a person purchases an aircraft in this state and the sale is exempt from sales tax on the basis the seller was not required to hold a California seller's permit, the purchaser must pay use tax measured by the sales price of the property to the purchaser. (Cal. Code Regs., tit. 18, § 1610(b)(1)(C).) Above, we concluded that appellant purchased the aircraft in this state on January 27, 2015. At the time the seller delivered title to the aircraft to appellant, the aircraft was being stored at Landmark Aviation in Fresno, California, and use tax applies to the storage of property in this state. (R&TC, § 6202.) Therefore, absent a specific exemption or exclusion, use tax applies to appellant's storage, use, and consumption of the aircraft in this state.

The Purchase Price

For purposes of the use tax, the taxable "sales price" means the total amount for which tangible personal property is sold, valued in money, whether paid in money or otherwise. (R&TC, § 6011(a).) The Aircraft Purchase Agreement specifies that the aircraft was sold to

[8] Appellant contends that the transaction is exempt from sales tax under R&TC section 6396 (interstate shipments) and CDTFA contends that the transaction is exempt from sales tax under R&TC section 6283.

[9] As relevant, appellant contends that R&TC section 6396 transactions are not consummated except by delivery outside the state. Nevertheless, by its own terms, this section only applies to "the computation of the amount of the *sales tax*." (R&TC, § 6396 [emphasis added].) Use tax applies unless the transaction was subject to sales tax. (R&TC, § 6401). The reason for a sales tax exemption is immaterial for purposes of imposing the use tax. (R&TC, § 6201.) Therefore, based on our finding that sales tax is inapplicable, we need not address appellant's contention that the sale of the aircraft qualifies as an exempt sale in interstate commerce (see R&TC, § 6396).

appellant "for the sum of $1,000,000 USD ('Purchase Price')." Therefore, we find that the purchase price was $1,000,000.

Appellant contends that the measure of tax is $1.00 and offered to pay the use tax applicable to selling the aircraft for $1.00 in full on the day of the oral hearing. In support, appellant refers to the FAA Bill of Sale, pursuant to which the parties reported a selling price of $1.00 to the FAA. Nevertheless, it is undisputed that appellant actually paid the full $1,000,000, as required in the Aircraft Purchase Agreement. Therefore, we conclude the measure of tax is $1,000,000, and not $1.00.

Exemptions from Use Tax

Appellant contends that its purchase of the aircraft is exempt from use tax because the aircraft was purchased for use in interstate commerce. The courts have concluded that statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 766, 769-770.) The taxpayer has the burden of establishing entitlement to the exemption or exclusion claimed. (*Ibid*.) An exemption or exclusion will not be inferred from doubtful statutory language; the statute must be construed liberally in favor of the taxing authority, and strictly against the claimed exemption. (*Ibid*.)

There are two bases for exempting or excluding use tax when an aircraft is purchased for use in interstate commerce. First, use tax does not apply to the use of property purchased for use and used in interstate commerce prior to its entry into this state, and thereafter continuously used in interest or foreign commerce both within and without this state and not exclusively in this state. (R&TC, § 6352; Cal. Code Regs., tit. 18, § 1620(b)(2)(B)1.) This exemption only applies to property purchased outside this state. Here, the sale and purchase of the aircraft occurred in this state. Therefore, appellant could not have used the aircraft in interstate commerce prior to bringing it into this state.

Second, there is a rebuttable statutory presumption that, when certain conditions are met, any "aircraft bought outside of this state . . . and which is brought into California within 12 months from the date of its purchase, was acquired for storage, use, or other consumption in this state." (R&TC, § 6248(a).) Nevertheless, "[t]his section shall not apply to any . . . aircraft used in interstate or foreign commerce pursuant to regulations prescribed by [CDTFA]." (R&TC, § 6248(c).) CDTFA's regulation implementing this section provides, "[i]f the property is an

aircraft, use tax will not apply if one-half or more of the flight time traveled by the aircraft during the six-month period immediately following its entry into the state is commercial flight time traveled in interstate or foreign commerce." (Cal. Code Regs., tit. 18, § 1620(b)(5)(C)3.) R&TC section 6248 is inapplicable because, by its own terms, that section is limited to property "bought outside of this state." Above, we concluded that the sale and purchase occurred in this state. Furthermore, the exclusion set forth in Regulation 1628(b)(5)(C), which interprets and implements R&TC section 6248, by its terms also only applies to aircraft purchased outside this state. This is also clear because the exclusion applies to aircraft used in interstate commerce "following its entry into the state." (Cal. Code Regs., tit. 18, § 1628(b)(5)(C)3.) Based on the above, we conclude that R&TC section 6248, which establishes a rebuttable presumption that use tax applies to certain out-of-state purchases, is inapplicable under the facts of this case because the sale and purchase of appellant's aircraft occurred in California. As such, appellant may not avail itself of the methods to rebut the statutory presumption set forth in R&TC section 6248, and as further prescribed in Regulation 1620. In summary, since R&TC section 6248 is inapplicable because the sale occurred in California, it is irrelevant whether appellant can further establish that R&TC section 6248 was separately made inapplicable based on appellant's qualified use of the aircraft in interstate commerce.

Based on the foregoing, the aircraft was being stored in California on the date of purchase, January 27, 2015, and was thereafter stored, used, and consumed in this state. Use tax applies to the storage, use or consumption of an aircraft in this state. (R&TC, § 6202.) Appellant has failed to establish that an exemption or exclusion applies. As such, we conclude that use tax applies to appellant's storage, use, and consumption of the aircraft in this state.

HOLDING

California use tax applies to appellant's storage, use, and consumption of the aircraft in this state.

DISPOSITION

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

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
0CC6C6ACC66A44D...
Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 3/23/2020