

STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

Heidrich Aviation, LLC,
Petitioner,

v

MTT Docket No. 358557

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Kimbal R. Smith III

FINAL OPINION AND JUDGMENT

The Tribunal, having given due consideration to the file in the above-captioned case, finds:

1. Administrative Law Judge Thomas A. Halick issued a Proposed Opinion and Judgment on October 24, 2011. The Proposed Opinion and Judgment states, in pertinent part, “[t]he parties have 20 days from date of entry of this Proposed Opinion and Judgment to file any written exceptions to the Proposed Opinion and Judgment.”
2. Neither party has filed exceptions to the Proposed Opinion and Judgment.
3. The Administrative Law Judge considered the testimony and evidence submitted and made specific findings of fact and conclusions of law. The Administrative Law Judge’s determination is supported by the testimony and evidence and applicable statutory and case law.
4. The Tribunal adopts the Proposed Opinion and Judgment as the Tribunal’s final decision in this case. See MCL 205.726. The Tribunal also incorporates by reference the Findings of Fact and Conclusions of Law contained in the Proposed Opinion and Judgment in this Final Opinion and Judgment.
5. Given the above:

a. The tax, interest and penalty as levied by Respondent are:

Assessment Number: Q074792

Tax	Interest	Penalty
\$102,000.00	\$7,194.90	\$25,500.00

b. The tax, interest and penalty as determined by the Tribunal are:

Assessment Number: Q074792

Tax	Interest	Penalty
\$67,230.00	To be calculated per 1941 PA 122	-0-

IT IS SO ORDERED.

IT IS FURTHER ORDERED that Respondent shall cause its records to be corrected to reflect the taxes, interest, and penalties as indicated herein within 20 days of entry of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that Respondent shall collect the affected taxes, interest and penalties or issue a refund as required by this Order within 28 days of entry of this Final Opinion and Judgment.

MICHIGAN TAX TRIBUNAL

Entered: December 9, 2011 By: Kimbal R. Smith III

* * *

**STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM – MICHIGAN TAX TRIBUNAL**

Heidrich Aviation, LLC,
Petitioner,

v

Michigan Department of Treasury,
Respondent.

Michigan Tax Tribunal
MTT Docket No. 358557

Administrative Law Judge Presiding
Thomas A. Halick

PROPOSED OPINION AND JUDGMENT

Petitioner appeals Respondent’s assessment of use tax upon an aircraft. A hearing was held on June 14, 2011. Petitioner was represented by Mark G. Cooper and Robert E. Lewis, Jaffe, Raitt, Heuer & Weiss, PC. Respondent was represented by Kevin T. Smith, Assistant Attorney General and Sara Clark Pierson, Department of Treasury. Petitioner presented testimonial and documentary evidence. The parties also submitted a “Joint Stipulation of Uncontroverted Facts and Issues to be Tried,” which was entered into evidence. Petitioner filed a post-hearing brief on August 12, 2011 and Respondent filed a brief on September 2, 2011. At issue are tax, penalty, and interest set forth in the following final assessment:

Assessment No.	Tax	Penalty	Interest*
Q074792	\$ 102,000.00	\$25,500.00	\$7,194.90

*As of the date of assessment (11/28/08). Interest accrues as provided by 1941 PA 122.

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The Tribunal holds that the final assessment of tax shall be AFFIRMED as modified herein and the penalty shall be waived as follows:

Assessment No.	Tax*	Penalty**	Interest*
Q074792	\$67,230	\$0.00	To be calculated per 1941 PA 122.

*The parties stipulated that if the Tribunal upholds the assessment the proper use tax base is the actual purchase price of the subject aircraft (\$1,120,514) with tax of \$67,230.

**The parties stipulated that the penalty should be waived.

Procedural History

On June 6, 2008, Respondent issued an “Intent to Assess” tax, which Petitioner contested at an informal conference held on October 30, 2008 before a Department of Treasury hearing referee, who recommended that the assessment be issued. Respondent issued Final Assessment Q074792 on November 28, 2008, which Petitioner appealed to the Tribunal on December 18, 2008. A prehearing conference was held in the Tax Tribunal on March 10, 2010. Petitioner was represented by Robert E. Lewis, Jaffe, Raitt, Heuer & Weiss, PC. Respondent was represented by Drew M. Taylor, Assistant Attorney General. On May 10, 2010, Respondent filed a motion for summary disposition. On May 25, 2010, Petitioner filed a written response to Respondent’s motion requesting that the Tribunal deny Respondent’s motion and grant relief in favor of Petitioner under MCR 2.116(I). On February 17, 2011, the Tribunal dismissed some of the claims, but ruled that there are genuine issues of material fact pertinent to the sole remaining issue of whether Petitioner was engaged in the business of leasing aircraft within the meaning of

Rule 82. On April 8, 2011, a status conference was held to discuss whether this case should be placed in abeyance pending the outcome of all appeals in a factually and legally similar case, *Devonair Enterprises, LLC v Dep't of Treasury*, MTT Docket No. 358558. A Proposed Opinion and Judgment was entered in *Devonair* on January 5, 2011, which was adopted by the Tribunal by a Final Opinion and Judgment entered April 5, 2011. On April 27, 2011, the petitioner in *Devonair* filed a claim of appeal to the Court of Appeals. Based on discussions with counsel at the April 8, 2011 status conference, it was determined that this case should not be placed in abeyance and this case was heard on June 14, 2011. The parties stipulated to the admissibility and authenticity of the following exhibits:

Petitioner's Exhibits:

- P-1. Intent to Assess Q074792 (Bill for Taxes Due)
- P-2. Wikipedia information – Eclipse 500 aircraft
- P-3. FAA Aircraft Registration application
- P-4. Final Assessment Q074792 (Bill for Taxes Due)
- P-5. Aircraft Lease Agreement (Richard A. Heidrich)
- P-6. Aircraft Lease Agreement (Richard Tool & Die Corporation)
- P-7. Aircraft Lease Agreement (Marc Schechter)
- P-8. April 20, 2008 Use Tax Return
- P-9. Letter from Aero-Space Reports to Petitioner re: bill of sale and other documents, dated 11-9-07

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- P-10. Article re: Eclipse Corporation bankruptcy
- P-11. Eclipse 500 Total Operating Costs Compared to other Aircraft
- P-12. Invoice for rental payments to Richard A. Heidrich, dated 3-24-08
- P-13. Aviation Week article, dated 3-24-09
- P-14. Aircraft Lease Agreement (Rocky Mountain Sport Jets)
- P-15. Aircraft Lease Agreement (Richard Tool & Die Corporation)
- P-16. Advertisements for aircraft by Rocky Mountain Sport Jets
- P-17. Letter from Eclipse to “All Eclipse 500 Owners and Depositors,” dated May 18, 2009
- P-18. Aviation Week Article re: shut down of Eclipse Corporation
- P-19. SalemFive Invoice dated 5/13/11 to Heidrich Aviation, LLC and loan documents
- P-20. All invoices from 3/1/08 to 6/1/11 for leasing the subject aircraft
- P-21. Eclipse 500 Total Operating Costs Compared to Other Aircraft
- P-22. Eclipse Partnership costs
- P-23. UHY Advisors’ memo to Rick Heidrich from Connie Ku, January 7, 2008
- P-24. Business & Commercial Aviation article: “2007 Operations Planning Guide,” 8/07
- P-25. Business & Commercial Aviation article: “2007 Operations Planning Guide,” 8/09
- P-26. Customer Contact List
- P-27. Aircraft Lease Agreement (Blair McKendrick), April 3, 2011
- P-28. Aircraft Lease Agreement (Fred Perenic), August 30, 2010
- P-29. Aircraft Lease Agreement (Jim Palmer), August 15, 2010

P-30. Aircraft Lease Agreement (Jim Palmer), December 14, 2010

P-31. Email to Rick Heidrich from Jane McBride, June 11, 2008

Respondent's Exhibits:

R-1. Aircraft Purchase Documents, October 31, 2007

R-2. Aircraft Registration Application, October 31, 2007

R-3. Aircraft Transfer Questionnaire

R-4. Intent to Assess Q074792 (Bill for Taxes Due)

R-5. Informal Conference Decision and Order of Determination, November 20, 2008

R-6. Final Assessment Q074792 (Bill for Taxes Due)

R-7. Aircraft Lease Agreement (Richard A. Heidrich)

R-8. Aircraft Lease Agreement (Richard Tool & Die Corporation)

R-9. Aircraft Lease Agreement (Marc Schechter)

R-10. Use Tax Registration, February 1, 2008

R-11. 2008 Quarterly and Annual Use Tax Returns

R-12. 2008 Quarterly Use Tax Returns

R-13. Summary of Lease Hours and Use Taxes for January 2008 – March 2010

Findings of Fact

This section is a “concise, separate, statement of facts” within the meaning of MCL 205.751, and, unless stated otherwise, the matters stated or summarized are “findings of fact” within the

meaning of 1969 PA 306, MCL 24.285. The parties offered into evidence a “Joint Stipulation of Uncontroverted Facts and Issues to be Tried,” which is incorporated herein by reference.

Petitioner, Heidrich Aviation, LLC, was formed upon filing articles of organization with the state of Michigan on July 24, 1996,¹ at which time Richard A. Heidrich was the sole member.² Petitioner was formed for the purpose of owning small aircraft and previously owned two aircraft that were sold in 1999 and 2004. The articles of organization indicate that Petitioner is authorized to conduct any lawful activities (not limited to the ownership and leasing of aircraft).

Petitioner took delivery of the subject aircraft on October 31, 2007, at the manufacturer’s location in New Mexico. Petitioner borrowed purchase money in the amount of \$984,400 from Salem Five Cents Savings Bank, which was granted a security interest in the subject aircraft. The monthly principal and interest payments on the loan were \$7,397.49. P-19.

Prior to acquiring the subject aircraft, Mr. Heidrich entered into discussions with Marc Schechter regarding participating in the LLC, after which time Mr. Schechter’s trust became a member/manager of the LLC. TR 14. Petitioner’s members acquired the aircraft through the LLC primarily for their own personal use and also to lease it to others; however, a significant portion of the leasing activity was geared toward locating additional members for the LLC, who would have the same right to lease the aircraft as Mr. Heidrich and Mr. Schechter and to share in fixed

¹ Official notice is taken of this judicially cognizable fact based on a public record. MCL 24.277.

costs. The evidence does not include any documents relating to the organization of the LLC or any agreements between the members regarding their respective obligations and rights.

On August 20, 2010, Mr. Heidrich and Mr. Schechter sought to bring a third or fourth member to the LCC. Petitioner leased the aircraft to Mr. Fred Perenic, a prospective member, for \$300 per hour, so he could determine its suitability for his personal and business purposes. TR 48. Mr. Jim Palmer also leased the aircraft for this purpose. TR 50. If a new member had been added, he would have participated in the fixed costs. TR 50.

The members anticipated that they would use the aircraft personally for 150 hours annually at the rate of \$300 per hour and others would lease it to unrelated parties for 300 hours annually at \$500 per hour, for a total of 450 hours of flight time annually. At the time of purchase, Petitioner purchased a “Jet Complete” service contract from Eclipse Aviation for approximately \$67,000, pursuant to which the manufacturer was responsible for most repairs and maintenance for 450 flight hours (estimated to be one year of use).

The fixed costs related to ownership of an aircraft are: insurance, the hangar and storage, and certain fixed maintenance costs (such as periodic inspections).

Variable costs are those costs that vary based on the hours of use of the aircraft, including:

2 As of the date of the hearing, Mr. Heidrich’s trust is a member, and not Mr. Heidrich individually.

maintenance (such as tires, brakes, and oil), repairs, jet fuel, landing fees, other airport costs, and pilot fees. TR17.

Mr. Heidrich testified that he had been flying other aircraft at the time Petitioner purchased the Eclipse 500. The other aircraft did not generate any revenue. He stated that he saw the subject aircraft as providing “a chance to be in the airplane business and have a chance to fly it personally as well, but just as importantly, to create revenue that paid for the whole thing and was even profitable. The whole idea was to make a profit” TR 18:15-19. Along a similar vein, Mr. Heidrich stated, “. . . we did want to create revenue outside of our own use and make it a business, an operating business.” TR 20:17. Mr. Heidrich’s assertions regarding the business purposes of Heidrich Aviation, LLC, involves a legal conclusion as to whether Petitioner was engaged in the *business* of leasing aircraft to others, which cannot be accepted at face value as a fact. However, it is a fact that Mr. Heidrich and Mr. Schechter desired to reduce or eliminate the costs of aircraft ownership by leasing the aircraft to others when they were not using it.

Essentially, the plan was to allow Mr. Heidrich, Mr. Schechter, and Mr. Heidrich’s business, Richard Tool & Die Corporation (“Richard Tool”) to use the aircraft and to cover all or part of the costs of aircraft ownership by leasing it to others. TR 23.

Petitioner intended to lease the aircraft to Richard Tool, an automotive parts supplier, for use in its business activities, including flights to visit customers in Tennessee, Kentucky, and Alabama. Mr. Heidrich is an owner of Richard Tool, and he has worked for that company his entire career.

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Richard Tool leased the aircraft for a total of 21.7 hours over a period of approximately 3.5 years.

It was anticipated that Mr. Heidrich, Mr. Schechter, and Richard Tool would use the aircraft for a combined total of 150 hours per year but this never materialized. Mr. Heidrich leased the aircraft for only 166.3 hours from 2008 through June 2011, and Mr. Schechter leased it for only 12.5 hours during that period.

Rather than 450 hours per year as planned, the aircraft was leased for 254.5 hours from January 2008 through May 31, 2011, for an average of approximately 74.5 hours per year.

The dry lease rate was \$300 per hour for Mr. Heidrich, Mr. Schechter, and Richard Tool. The dry lease rate for “outside entities” was generally \$500 per hour. TR 25:14. (Mr. Heidrich used the term “outside entities” to distinguish between leases to persons other than related entities – himself, Mr. Schechter, and Richard Tool.) The members believed that outside entities would lease the aircraft for 300 hours per year. At these rates, the aircraft would have generated \$150,000 in annual gross revenue from “outside entities.” TR 25:19. In actuality, Petitioner leased the aircraft to persons other than Mr. Heidrich, Mr. Schechter, and Richard Tool for approximately 15 to 20 hours annually over a three and one half year period. TR 72. There are no written lease agreements in evidence for six of the twelve users invoiced. TR 41:18.

Mr. Heidrich explained the reason for the two rates as follows:

We were very confident the \$300 would cover . . . the variable costs. Since, Mr. Schechter and I put all the capital into it and were paying – in effect, paying the fixed cost, the hangar and the insurance and such, the \$300 . . . that we were paying was in effect covering the variable costs plus a profit. In the event of leasing, dry leasing it - - we need to explain that because earlier when I was talking about variable costs, it included fuel and pilots and all that, and those are not included. TR 28:11-20.

With regard to the lease rate charged to others, Mr. Heidrich stated:

In leasing it to a person, you know, a third party, so to speak, somebody else that wanted to use the aircraft was certainly the intent, they weren't paying the bills, they weren't paying for the insurance and the hangar and all that. So the difference in the lease – and again, this was an initial rate . . . because we had all those extra expenses and, you know, part of the cost and part of defraying the overall costs involved and covering those fixed expenses as well. . . . TR 28-29.

The following costs were associated with ownership and operation of the aircraft:

“Jet-Complete” maintenance contract ³	\$67,000/yr	\$149/ hr
Hangar	\$15,000/yr	\$33/hr
Insurance	\$40,000/yr	\$89/hr
Debt Service – 20 Year Loan	<u>\$92,400/yr</u>	<u>\$197/ hr</u>
Total	\$214,000	\$468/hr

Petitioner's stated goal was to produce annual rental revenues of \$195,000, for 450 hours of use by related entities and outside entities, which is less than the annual costs identified above.

Many Eclipse 500 aircrafts, including the subject, were not complete when delivered to the

³ This applied to the first year of operation or 450 hours.

customers. For example, the subject aircraft was missing certain avionics equipment and other equipment that would allow the aircraft to fly into “known icing conditions.” This made it difficult or impossible to lease the aircraft to third parties for use during the winter. On

November 25, 2008, Eclipse Aviation filed for bankruptcy protection after which time replacement parts for the aircraft were difficult to obtain and new pilots could not be trained. TR 54-59 and P-18.

Petitioner claims to have made “substantial efforts” to lease the aircraft to third parties, but careful examination of the testimony reveals few concrete details in this regard. TR 42. Mr. Heidrich stated that there is “a lot of business activity, a lot of leasing activity” at the Oakland Pontiac Airport where the aircraft was located. But he was very vague as to how Petitioner pursued that leasing market. He stated that “[t]here’s certain people in Pontiac like Chris Lentini that manage aircraft. They know who’s looking for what kind of aircraft to lease. . . . We spent a lot of time and effort trying to get those people up in the Pontiac and Detroit area.” TR 43.

Despite these general assertions, there is no detail regarding what specifically was done to reach the potential lessees. He did not testify that Petitioner hired Mr. Lentini or anyone else to market the aircraft. Mr. Heidrich belongs to a business organization called Young President’s Organization, and he stated that “. . . in our forums and different advertisements, we would get a lot of business owners and say we’re out there looking to rent it.” TR 44. There is no documentary evidence to support a finding that any formal advertising was placed in any type of

forum of the Young President's Organization. Much of the efforts to lease the aircraft were by "word of mouth." TR 45. Overall, this testimony does not credibly establish that Petitioner operated as a leasing business.

Steve Cirino of Rocky Mountain Sport Jets is a retired commercial airline pilot who trained Mr. Heidrich to be certified by the Federal Aviation Administration to fly the Eclipse 500. Rocky Mountain Sport Jets is a fixed base operator that charters aircraft, including Eclipse 500 aircraft like the subject, to the general public. Mr. Heidrich stated that he spoke with Mr. Cirino about leasing the aircraft, and located several lessees through that contact.

Rocky Mountain Sport Jets placed advertisements in Crain's Business Weekly in both Cleveland and Detroit regarding the availability of Eclipse 500 aircraft for charter or joint ownership. P-16. None of the advertisements included in exhibit P-16 mention dry leasing. Rather, the first page of P-16 refers to a 1/8th Joint Ownership for \$200,000. The second page of P-16 refers to providing flight crew management and factory-trained pilots, and does not refer to dry leasing. Petitioner paid for some of the ads. TR 46:17. According to Mr. Heidrich, several of the leases from Petitioner to others were arranged through contacts provided by Mr. Cirino. Upon cross-examination, counsel for Respondent established that the advertisements discussed ownership options rather than leasing. TR 76:1.

Exhibit P-16 includes a copy of an advertisement for Rocky Mountain Sport Jets, which Mr.

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Heidrich referred to as a flyer. There is no evidence that this particular flyer was ever distributed to anyone. The flyer relates to purchase or joint ownership and does not refer to leasing. P-16 also includes a page from Crain's Detroit Business that shows an advertisement that advertises "VLJ Ownership Options Available Immediately...Starting from \$185,000." "VLJ" stands for very light jet, and "ownership options" refers to joint ownership. There is nothing in these advertising materials that specifically refers to Petitioner or the subject aircraft and nothing about leasing. The advertisements do not identify Petitioner as an aircraft leasing company. Mr. Heidrich testified that Petitioner paid for *one* such advertisement in Crain's on October 19, 2009. P-16 includes an invoice from Crain's that was issued to Rocky Mountain Sport Jets on October 19, 2009, for advertising in the amount of \$407.84. Mr. Heidrich stated that Petitioner "was paying for some of the ads" and that P-16 shows an ad that he tore out of Crain's, which was "the final one a demonstration from '09 when we – Heidrich Aviation paid – apparently we paid direct to Crain Communication. . . on behalf of Rocky Mountain in support of our cost sharing." TR 47. This testimony does not establish that the advertisement was published more than one time. This single advertisement and "word of mouth" do not constitute substantial efforts to lease the aircraft to third parties.

Petitioner leased the subject aircraft to Blair McKendrick for \$500 per hour for 7.2 hours under a lease dated April 3, 2011. P-27.

Petitioner leased the subject aircraft to Fred Perenic for \$300 per hour for 1.8 hours under a lease

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dated August 30, 2010. P-28. Petitioner held discussions with Mr. Perenic and Jim Palmer regarding becoming a member of the LLC. Mr. Perenic used the subject aircraft pursuant to the lease in order to determine whether the aircraft would meet his needs individually and the needs of his business. Petitioner gave Mr. Perenic a favorable “partner’s rate” during this time while he was investigating whether to become a member of the LLC. TR 48.

Petitioner leased the subject aircraft to Jim. Palmer under leases dated August 15, 2010 and December 14, 2010 for lease rates of \$300 and \$600 per hour, respectively. P-29 and P-30. Mr. Palmer leased the aircraft for a total of 9.2 hours.

Petitioner leased the subject aircraft to Rocky Mountain Sport Jets for 17.2 hours for \$610 per hour under a lease dated August 25, 2010. P-14.

In 2007, when Petitioner first considered third-party leasing, there were no available pilots who were certified to fly the subject aircraft. Mr. Heidrich believed there would eventually be 10 to 20 certified pilots in the Pontiac area. TR 69:10. Mr. Heidrich and Mr. Cirino were the only pilots certified to fly the Eclipse EA 500 at that time at or near the airport where the subject aircraft was based. The evidence does not identify any other certified pilots in 2007 or thereafter. Therefore, it was highly unlikely that an active dry leasing market would emerge until more pilots were certified, which is a relatively intensive and time-consuming process.

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Mr. Schechter anticipated using the aircraft personally for 50 hours annually, but this did not occur. This is allegedly because the aircraft was not available due to the lack of parts, escalating fuel costs, and the unavailability of qualified pilots. However, the fact that Mr. Heidrich and others used the aircraft each month from January 2008 through March 2010 tends to prove that the aircraft could be operated without regard to the alleged shortage of parts or rising fuel costs. Mr. Schechter was not “rated” or certified to operate the Eclipse 500. He was not actively involved in the management of Petitioner.

Exhibit P-20 consists of a series of invoices dated March 1, 2008 through June 1, 2011. The first set of invoices were billed monthly to Richard A. Heidrich, dated March 1, 2008 to August 1, 2008, with terms of payment “net 30.” Several of the invoices are stamped “PAID 12/21/2009.” The “dry lease rate” was \$300 per hour and a charge for 6% use tax was itemized.

Exhibit R-11 is Petitioner’s 2008 Annual Return for Sales, Use and Withholding Taxes, which reports rentals of \$19,230 with use tax due in the amount of \$1,153.80.

Exhibit R-13 is a summary of hours of operation, the user, the rentals paid, and use tax. 4 Petitioner collected and remitted a total of \$2,651.85 in use tax from January 2008 through March 2010, during which time the aircraft was leased for a total of 128.7 hours. Richard A. Heidrich leased the aircraft for 36.4 hours in 2008, 45 hours in 2009, and 14.3 hours from

4 This same document was also admitted as Petitioner’s Exhibit P-12.

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January 2010 to March 2010 (a total of 95.7 hours for that period). The use tax attributable to those hours was \$1,722.60. Mr. Schechter used the aircraft for a total of 12.5 hours from January 2008 through March 2010. The aircraft was leased to persons other than Mr. Heidrich or Mr. Schechter for a total of 20.5 hours from January 2008 through March 2010. R-13. The lease rate for Mr. Heidrich and Mr. Schechter was \$300 per hour.

The aircraft was first leased to a person other than Mr. Heidrich or Mr. Schechter in August 2008. R-13 indicates that the aircraft was leased for 2.6 hours in August 2008 for a rental payment of \$1,300 (\$500 per hour) and that \$78 in use tax was paid. R-13 does not identify the name of the lessee.

The aircraft was leased in September 2008 for 3 hours for a total rental payment of \$900 (\$300 per hour). The document does not identify the name of the lessee. The lease rate was \$300 in September but \$500 in October -- the testimony explained that certain prospective members were charged the lower "partner rate" while exploring the possibility of joining the LLC.

The lease payment divided by the hours indicates that for August 2008 and October 2008 the rate was \$500 per hour. For September 2008, the lease rate was \$300 per hour. For May 2009, February 2010, and March 2010, the lease rate was \$300 per hour. For September 2009, the lease rate was \$795 ($\$1,987.50 / 2.5 \text{ hours} = \795).

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Invoice #107 (P-20) indicates that an individual named Jay Bielfield leased the aircraft in August 2008 for 2.6 hours for a total rental fee of \$1,395.86 (at the rate of \$500 per hour).

Invoice #108 shows that “Richard Tool & Die Corporation” leased the aircraft in August 2008 for 3 hours at the rate of \$300 per hour.

Invoice #112 shows that “Virchow, Krause & Co – Barry Lefkowitz” leased the aircraft in October 2008 for 1.6 hours for \$500 per hour.

Invoice #122 shows that “Richard Tool & Die Corporation” leased the aircraft for 3.4 hours in May 2009 for \$300 per hour.

Invoice #117 dated September 9, 2009, shows that “Toledo Orthopedics – Tony Frogamini” leased the aircraft for 2.5 hours at the rate of \$795 per hour.

Invoice #130 shows that “Richard Tool & Die Corporation” leased the aircraft in February 2010 for 4.6 hours at the rate of \$300 per hour.

Invoice #128 shows that “Marc Schechter” leased the aircraft in February 2010 for 5.9 hours at the rate of \$300 per hour.

Invoice #131 shows that “Richard Tool & Die Corporation” leased the aircraft in February 2010

for 2.8 hours at the rate of \$300 per hour.

Invoice #133 shows that “Richard Tool & Die Corporation” leased the aircraft in April 2010 for 2 hours at the rate of \$300 per hour.

Invoice #136 shows that Richard Tool & Die Corporation leased the aircraft in June 2010 for 2.2 hours at the rate of \$300 per hour.

Invoice #137 shows that “isuppli Partners, LLC” leased the aircraft in June 2010 for 3.1 hours at the rate of \$300 per hour.

Invoice #138 was billed to “Hedirich (sic) Aviation, LLC” for 3.1 hours at the rate of \$300 per hour. The purpose of the flight was “Trip for prospective partner (Jim Palmer).”

Invoice #141 shows that “Fred Perenic” leased the aircraft in August 2010 for 1.8 hours at the rate of \$300 per hour.

Invoice #142 shows that “Jim Palmer” leased the aircraft in August 2010 for 3.1 hours at the rate of \$300 per hour.

Invoice #143 shows that “Rocky Mountain Sport Jets” leased the aircraft in August 2010 for 1.8 hours at the rate of \$610 per hour.

Invoice #145 shows that “Jim Palmer” leased the aircraft in September 2010 for 3 hours at the rate of \$300 per hour.

Invoice #147 shows that “Rocky Mountain Sport Jets” leased the aircraft in August 2010 for 15.4 hours at the rate of \$610 per hour.

Invoice #150 shows that “isuppli Partners, LLC” leased the aircraft in October 2010 for 1.9 hours at the rate of \$300 per hour.

Invoice #152 shows that “Jim Palmer” leased the aircraft in December 2010 for 3.1 hours at the rate of \$600 per hour.

Invoice #154 (12/19/2010) shows that “Toledo Orthopedics – Tony Frogamini” leased the aircraft at the rate of \$755.25 per hour.

Invoice #160 (3/28/11) was billed to Marc Schechter for a “Capital Charge to balance partner accounts” in the amount of \$70,000.

Invoice #161 was billed to “Blair Mckendrick” for 7.2 hours of “Dry Lease for April aircraft use” at the rate of \$500 per hour.

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Exhibit P-26 is a “Heidrich Aviation, LLC Customer Contact List” dated June 6, 2011, which lists the names of 12 individuals or entities that have leased the aircraft and which are also identified on the invoices described above. The table below is based on Exhibits P-26 and P-20 (invoices dated March 21, 2008 through June 1, 2011).

<u>Lessee</u>	<u>Hours of Use</u>	<u>Rate</u>	<u>Rental</u>
Jay Bielfield	2.6	500	1,300
Blair Mckendrick	7.2	500	3,600
Fred Perenic	1.8	300	540
Richard A. Heidrich	167.9	300	50,370
Heidrich Aviation, LLC	4.3	300	1,290
isupply Partners, LLC	5	300	1,500
Jim Palmer ⁵	6.1	300	1,830
	3.1	600	1,860
Virchow, Krause & Co – Barry Lefkowitz	1.6	500	800
Richard Tool & Die Corporation ⁶	21.7	300	6,510
Rocky Mountain Sport Jets	17.2	610	10,492
Marc Schechter	12.5	300	3,750
Toledo Orthopedics – Tony Frogamini ⁷	2.5	795	1,987.50

⁵Jim Palmer paid two different rates as indicated.

⁶ Mr. Heidrich was a member of isuppli Partners, LLC.

⁷ Toledo Orthopedics paid two different rates. See, invoices #154 and #117. P-20.

1	<u>755.25</u>	<u>755.25</u>
254.5		86,584.75

Total Use Tax @ 6% \$5,195.08 (based on invoices dated 3/1/2008 to 6/1/2011)

The evidence includes a copy of a written lease for the following persons: Blair Mckendrick (P-27), Fred Perenic (P-28), Richard A. Heidrich (P-5), Richard Tool & Die Corporation – January 1, 2008 (P-6 and P-15), Marc Schechter (P-7), Jim Palmer (P-29 and P-30), and Rocky Mountain Sport Jets (P-14).

There is no evidence of any written lease for the following persons: Toledo Orthopedics – Tony Frogamini, Virchow, Krause & Co – Barry Lefkowitz, isuppli Partners, LLC, and Jay Bielfield.

Conclusions of Law

The sole issue is whether Petitioner is eligible to pay use tax on rental receipts or required to pay tax on the entire purchase price of the subject aircraft. This turns upon whether Petitioner was a “lessor” as that term is used in MCL 205.95(4) that was “engaged in the business of renting or leasing tangible personal property to others. . .” as required by 1979 AC, R 205.132 (“Rule 82”).

Tangible personal property purchased outside of Michigan and brought into Michigan within 90 days of purchase is presumed to be acquired for storage, use, or other consumption in this state. MCL 205.93(1). There is no dispute that the subject aircraft was stored, used, or consumed

within this state and, therefore, is subject to use tax. The use tax act provides:

(4) A lessor may elect to pay use tax on receipts from the rental or lease of the tangible personal property in lieu of payment of sales or use tax on the full cost of the property at the time it is acquired. For tax years that begin after December 31, 2001, in order to make a valid election under this subsection, a lessor of tangible personal property that is an aircraft shall obtain a use tax registration by the earlier of the date set for the first payment of use tax under the lease or rental agreement or 90 days after the lessor first brings the aircraft into this state. MCL 205.95(4).

The department's administrative rule, 1979 AC, R 205.132 ("Rule 82") provides:

Rule 82. (1) A person engaged in the business of renting or leasing tangible personal property to others shall pay the Michigan sales or use tax at the time he purchases tangible personal property, or he may report and pay use tax on the rental receipts from the rental thereof. A person remitting tax on the purchase price as a purchaser-consumer or remitting tax on rental receipts as a lessor, shall follow 1 or the other methods of remitting for his entire business operation. A person remitting tax on rental receipts shall be the holder of a sales tax license, or a registration as is provided in the use tax act. Each month such lessor shall compute and pay use taxes on the total rentals charged. 1979 AC, R 205.132.

The Tribunal's Order denying the motions for summary disposition entered April 11, 2011 ruled that Petitioner was registered for use tax purposes and the parties stipulated to that effect on the record at the hearing. MCL 205.95(4).

Burden of Proof

The Tribunal has ruled that the election under Rule 82 is an exemption for which the taxpayer bears the burden of proof. While recognizing that the election under Rule 82 is not a "wholesale exemption from payment of use tax" the Tribunal treated it as an "exemption or exclusion" and required the taxpayer to "clearly establish its applicability" by a preponderance of the evidence.

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Masse v Treasury, MTT Docket No. 100087 (1989), citing *Edison v Dep't of Revenue*, 362 Mich 158, 162; 106 NW2d 802 (1961).

Petitioner argues that MCL 205.95(4) is not an exemption, but merely provides an alternative method for paying the use tax. It is true that section 95 deals generally with registration requirements and not exemptions. Section 95(4) sets forth registration requirements for lessors electing to pay use tax on rental receipts.

Section 95(4) is procedural in nature in that it sets deadlines for obtaining use tax registration as a prerequisite to claiming certain exemptions found in the sales and use tax acts. Storing, using, or consuming tangible personal property for any purpose, including leasing property to others, is a taxable use. MCL 205.93(1) and MCL 205.92(b). Property purchased for purposes of leasing it to others may qualify for an exemption for “property purchased for resale.” MCL 205.94(2)(c)(i). The use tax act does not define “resale” or “sale”; however, “purchase” is defined to include “rental,” and “price” includes lease or rental. MCL 205.92(e) and (f). Therefore, the price of property purchased for resale or for leasing is exempt, but a leasing transaction is itself a taxable use and the rental receipts are subject to tax.

The use tax act provides an exemption for rental receipts if the rented property was previously subject to use tax or sales tax. MCL 205.94a(i) and (ii). Property purchased in this state for purposes of leasing is exempt from sales tax on the purchase price if the lessor is licensed under the use tax act and the rental receipts are taxed. MCL 205.54d. A purchase by a leasing company is only exempt from sales tax if the lease receipts are taxed. Rule 82 explains the interrelated

application of the sales and use tax acts. 1979 AC, R 205.132. It explains how a qualified lessor claims the exemption from sales or use tax on the purchase price. Rule 82 and MCL 205.95(4) implement these statutory exemptions. The burden of proof is upon the taxpayer.

Discussion of Law and Facts

Petitioner has paid \$5,195.08 in use tax (based on invoices dated 3/1/2008 to 6/1/2011) on an aircraft valued at over \$1.1 million, for which the tax would otherwise be \$67,230.77, if paid at the time of purchase in October 2007.

The facts establish that Petitioner was not a “lessor” as that term is used in MCL 205.95(4)., Under Rule 82, an eligible “lessor” must be “[a] person engaged in the business of renting or leasing tangible personal property to others. . . .” *Id.* The leases to Mr. Schechter, Mr. Heidrich, the related company Richard Tool & Die Corporation, and certain others were not arm’s-length transactions and did not reflect market rents. Furthermore, Petitioner made no substantial effort to hold itself out to the public as a leasing business such as by advertising or other marketing efforts. Finally, Petitioner has not proven that the total number of hours that the aircraft was leased to unrelated parties is reflective of a leasing business. These factors and the totality of the circumstances support a legal conclusion that Petitioner was not a “lessor” that was *engaged in the business of leasing property to others*, and therefore, Petitioner is disqualified for the rental receipts election. See *Devonair Enterprises, LLC v Dep’t of Treasury*, MTT Docket No. 358558 (April 5, 2011)⁸.

⁸ The petitioner in *Devonair* filed a claim of appeal to the Court of Appeals on April 27, 2011.

Charging a below-market rental is no different than if two related parties sold a vehicle at a below-market price in order to avoid use tax. Whether a buyer and seller collude to report an understated price or actually agree to a below-market price, the law provides that the use tax is based upon the fair market value of the vehicle, which is not necessarily the actual consideration or the amount reported to the state. “The base price to be used in computing the tax liability shall not be less than its retail dollar value as listed in any recognized guide for use or appraisal purposes.” 1979 AC, R 205.135(5). The law requires the use tax to be based upon the actual retail value, whether the tax is applied to the full purchase price or rental receipts.

History of Rule 82 and MCL 205.95(4)

In 1972, the Department of Treasury adopted Rule 82 to clarify the sales and use tax implications for a person engaged in the business of leasing property to others. The taxpayer may either pay sales or use tax on the purchase price upon acquisition of the property, or remit use tax on the rental receipts received from its lessees.

Rule 82. (1) A person engaged in the business of renting or leasing tangible personal property to others shall pay the Michigan sales or use tax at the time he purchases tangible personal property, or he may report and pay use tax on the rental receipts from the rental thereof. A person remitting tax on the purchase price as a purchaser-consumer or remitting tax on rental receipts as a lessor, shall follow 1 or the other methods of remitting for his entire business operation. A person remitting tax on rental receipts shall be the holder of a sales tax license, or a registration as is provided in the use tax act. Each month such lessor shall compute and pay use taxes on the total rentals charged. 1979 AC, R 205.132.

Respondent’s Post-Hearing Brief points out that the Rule 82 election was codified by 2002 PA

255. For the periods at issue, the use tax act provided:

(4) A lessor may elect to pay use tax on receipts from the rental or lease of the tangible personal property in lieu of payment of sales or use tax on the full cost of the property at the time it is acquired. For tax years that begin after December 31, 2001, in order to make a valid election under this subsection, a lessor of tangible personal property that is an aircraft shall obtain a use tax registration by the earlier of the date set for the first payment of use tax under the lease or rental agreement or 90 days after the lessor first brings the aircraft into this state. MCL 205.95(4).

There is nothing in MCL 205.95(4) to indicate that the legislature intended to amend or repeal any part of Rule 82, or to otherwise alter the statutory framework upon which the Rule 82 election is based. The rule stands as a reasonable interpretation of the term “lessor” that now appears in statute and also implements the substantive statutory provisions regarding taxation and exemption. The rule continues to have the same force and effect of law as it did before the statute was enacted. The substance of Rule 82 is based on provisions of the sales and use tax acts that were in effect prior to and after 2002 PA 255. Rule 82 includes the word “lessor” – which is treated as synonymous with “person engaged in the business of renting or leasing.” The legislature was aware of the usage of “lessor” in Rule 82 when it adopted that term in 2002 PA 255. Nothing in the statute indicates that the legislature intended to vary the existing usage. By using the term “lessor” in section 95(4) rather than “person engaged in the business of leasing,” there is no indication that the legislature intended to refer to anyone other than a “lessor” within the meaning of the existing Rule 82. The legislature did not extend the Rule 82 election to persons not “engaged in the business of leasing.”

The purpose of 2002 PA 255 was to define “how the election is to be made” for a lessor of

aircraft.

The General Sales Tax Act and the Use Tax Act, taken together, allow a person or business entity engaged in the business of renting out or leasing tangible personal property the option of paying the sales tax on the property at the time of its purchase or paying the use tax on rental receipts. House Legislative Analysis Section, analysis of House Bill 4507 as enrolled, Public Act 255 of 2002, Second Analysis (7-11-02).

The above analysis specifically quotes Rule 82, including the requirement that a person must be “engaged in the business of leasing” and states that the legislation would clarify “when and how this election is to be made” upon the purchase of an aircraft. Even without reference to the legislative history, it is notable that 2002 PA 255 added a new subsection (4) to MCL 205.95, which pertains to *registration requirements only -- it is not an exemption section*. Had the legislature intended to alter the substantive exemption it would have amended sections pertaining to exemptions. The placement of the amendment in MCL 205.95 demonstrates that the legislature intended to clarify the procedure for claiming the Rule 82 election, not to change the substantive law on the relevant statutory exemptions that Rule 82 and section 95(4) implement. Therefore, the term “lessor” as it appears in sec. 95(4) must be interpreted consistent with Rule 82. The statutory term “lessor” means a “person engaged in the business of renting or leasing” tangible personal property to others. Absent clear indication in the body of the statute or the enacting section of 2002 PA 255, there are no grounds for disregarding any part of Rule 82 after the enactment of 2002 PA 255.

Analysis of the Sales and Use Tax Acts

From an examination of the sales and use tax acts, it can be determined that Rule 82 offers the taxpayer an election between two similar tax consequences and is not a tax avoidance mechanism. As discussed above, the use tax act provides an exemption for rental receipts if the rented property was previously subject to use tax or sales tax. MCL 205.94a(i) and (ii).

Therefore, if the lessor pays 6% sales or use tax upon acquisition of the property, the rental receipts are exempt from use tax. Rental receipts are also exempt if the lessor pays a sales or use tax to another state “levied at the rate of 6% or more.” If sales tax is paid to another state at a rate *less than* 6%, the rental receipts are not exempt. The meaning conveyed by these provisions is that the exemption for rental receipts applies as long as the 6% sales or use tax is paid. If 6% of the purchase price is remitted, the law is satisfied. If 6% of the stream of rental income is remitted, the law is satisfied. The use tax on the rental income is intended to compensate for transactions to which the sales or use tax is not paid upon purchase of the property.

The sales tax act provides a similar exemption for property purchased for leasing. That is, the seller is exempt from sales tax upon sale to the leasing company, if the property is to be leased to others, as long as the rental receipts from that property are subject to use tax, or specifically exempt from use tax. MCL 205.54d(a). But for the existence of this exemption, the seller would be required to pay sales tax on 6% of the purchase price and could collect that amount from the leasing company, or the leasing company would be required to pay use tax on the full retail value. The interrelationship between the sales and use tax acts suggests that there is an

equivalency between the two taxable events – the purchase of the property and leasing of the property – such that the tax implications are similar.

The use tax is a “. . . specific tax for the privilege of using, storing, or consuming tangible personal property in this state at a rate equal to 6% of the price of the property. . . .” MCL 205.93(1).

“Price” means “the total amount of consideration paid by the consumer to the seller...for which tangible personal property or services are sold, leased, or rented, valued in money...and applies to the measure of the tax.” MCL 205.92(f). “The base price to be used in computing the tax liability shall not be less than its retail dollar value as listed in any recognized guide for use or appraisal purposes.” 1979, AC, R 205.135(5). If the stated price of property is not reflective of “retail dollar value” (e.g., fair market value), the tax is nevertheless calculated on the market, or “retail dollar value.” This principal has application to our current facts where there are issues regarding whether the lease rates are consistent with fair market value.

In order to qualify to pay use tax on rental receipts, the taxpayer must be a “lessor.” MCL 205.95(4). Under Rule 82, an eligible “lessor” is “a person engaged in the business of renting or leasing tangible personal property to others.”

The Rule 82 election is only available to a person “engaged in the *business* of renting or leasing” and not merely to any person who enters a lease with another person. For example, assume that

John Doe is a sole member of JD, LLC, which is registered for use tax. The LLC purchases an aircraft for \$1,000,000 and leases it to John Doe for \$1 per flight hour. John Doe uses the aircraft for 100 hours per year. Thus, the taxpayer avoids \$60,000 in tax on the purchase price and instead remits \$6.00 in use tax on the rental receipts. Under such circumstances, it could not be said that JD, LLC is a qualified lessor that is engaged in the *business* of leasing aircraft to others. Even if the lease rate was \$200 per hour, the annual use tax on the rental income would be \$1,200, thus avoiding (or deferring) \$58,800 in tax. Assuming \$200 per hour is market rate, it would take 50 years for the taxpayer to pay \$60,000 in tax. It is not only the lease rate that is relevant, but also the total number of hours that the aircraft is leased. It could be held as a matter of law that JD, LLC was not engaged in the *business* of leasing under a straightforward application of the language of Rule 82, and would be liable for the \$60,000 tax based on the price, as would any other person who acquired a vehicle, boat, or aircraft for storage, consumption or use in this state. As discussed above, the tax consequences of an election under Rule 82 are intended to be equivalent to paying the tax at the time of acquisition.

The use tax act defines “business” as follows:

“Business” means all activities engaged in by a person or caused to be engaged in by a person with the object of gain, benefit, or advantage, either direct or indirect.
MCL 205.92(h).

In order to be eligible under Rule 82 and MCL 205.95(4), Petitioner must have engaged in the leasing of aircraft with the “object of gain, benefit, or advantage.” In order to constitute “business” the *object* of the endeavor must be for gain, benefit, or advantage, to the taxpayer,

whether or not actually realized. Neither party has cited any legal authority relevant to the meaning of “engaged in business” or “gain, benefit, or advantage” in the context of Rule 82.

Black’s Law dictionary defines “business” as “a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain.” Black’s Law Dictionary, (Abridged 7th ed), p 157. “Engaged” means: 1) Employed, occupied, or busy. 2) Committed as to a cause. The American Heritage College Dictionary, 2002, p 646. Engage, “To obtain the services of; employ...” *id.* The phrase “engaged in the business of leasing” implies a consistent, regular, and systematic effort to produce a gain, benefit, or advantage, from the leasing activity. The dictionary definitions are consistent with and help explain the statutory definition of “business” as that term appears in the context of Rule 82.

The Court of Appeals has considered the meaning of the term “business” in the context of a “business pursuits” exception in an insurance policy.

To constitute a business pursuit, there must be two elements: continuity, and secondly, the profit motive; as to the first, there must be a customary engagement or a stated occupation; and, as to the latter, there must be shown to be such activity as a means of livelihood, gainful employment, means of earning a living, procuring subsistence or profit, commercial transactions or engagements. *Riverside Insurance Company v Kolonich*, 122 Mich App 51; 329 NW2d 528 (1983).

In *State Mutual Cyclone Ins Co v Abbott*, 52 Mich App 103, 108; 216 NW2d 606, 608 (1974), the court approved of the following definition for the term “business”:

There can be no dispute that the definitions announced for (sic) by laymen and those applied by the courts have in common the aforesaid Two factors of continuity and the profit motive. *Without these, neither laymen nor jurist would call the rendition of service a business pursuit.* [Emphasis added].

The court noted that the term “business” as used in the law and understood by a layperson encompasses both “continuity and the profit motive.” Whether that term appears in an insurance contract, statute, or administrative rule, it carries a commonly understood meaning. This supports the notion that a “business” involves “continuity” or regularity of the activity. As applied to our current case, this would require that Petitioner actively seek to lease the aircraft to others so as to fully utilize the asset. Petitioner argues that no case prior to *Devonair* has required the lessor to hold itself out to the public as offering leasing services; however, this is inherent in the language of Rule 82, which requires the lessor to be *engaged* in leasing property to *others*. A leasing business would be expected to be actively *engaged* in communicating to *others* regarding the leasing services. This naturally entails some form of communication aimed at prospective customers. While this does not necessarily require media advertising, it would certainly be a strong indication that the enterprise is operating as a true leasing business.

Petitioner entered into written leases of indefinite duration with seven lessors. The leases between Petitioner and Richard A. Heidrich, Marc Schechter, and Richard Tool & Die Corporation were entered on January 1, 2008. The lease to Fred Perenic was entered August 30, 2010, the lease to Blair Mckendrick was entered April 3, 2010, and the leases to Jim Palmer were entered April 15, 2010 and December 14, 2010. The lease to Rocky Mountain Sport Jets was

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entered August 25, 2010. However, the total time that the aircraft was leased to outside entities reflects little continuity in the leasing activity to others. The vast majority of hours were leased to related persons, which is characteristic of a fractional ownership (or joint ownership) arrangement rather than a true leasing business.

There is no evidence of a written lease to Jay Bielfield, who used the aircraft on August 19, 2008 and August 21, 2008 for a total of 2.6 hours. According to invoice # 107 (P-20), Mr. Bielfield was billed \$500 per hour. He was also billed \$8.93 for two landing fees, which is not consistent with other invoices in evidence. There is no written lease in evidence. It is concluded that there was no such lease in existence. As such, it is not clear that operational control of the aircraft transferred to Mr. Bielfield. This is not reflective of a typical leasing transaction by a leasing business.

Virchow, Krause & Co – Barry Lefkowitz was billed for 1.6 hours of use on October 29, 2008, for the rate of \$500 per hour (no landing fees were invoiced). P-20. Again, there is no written lease in evidence and it must be concluded that no such lease existed.

Toledo Orthopedics was billed for 2.5 hours of use by invoice # 117 dated September 30, 2009 for the rate of \$795 per hour. P-20. Toledo Orthopedics was billed for one hour of use by invoice # 154 dated December 19, 2010 for the rate of \$755.25 per hour (use tax is not itemized on this invoice). There is no written lease in evidence and it must be concluded that no such lease

existed. There is no evidence to explain why the rates far exceeded the rates charged to others.

A company called isuppli Partners, LLC, was billed for 3.1 hours of use by invoice # 137 dated July 8, 2010 for the rate of \$300 per hour. P-20. There is no written lease in evidence and it must be concluded that no such lease existed. Heidrich testified that he was a member of isuppli Partners, LLC, with another “partner,” which explains the lower rate. TR 73.

Jim Palmer was billed for 3.1 hours of use by invoice # 142 dated September 1, 2010 for the rate of \$300 per hour. P-20. Jim Palmer was billed for 3.1 hours of use by invoice # 152 dated December 15, 2010 for the rate of \$600 per hour. P-20. The alleged reason for the change in the lease rate was that Mr. Palmer had decided not to join the LLC as a member and therefore the preferential “partners” rate no longer applied.

Rocky Mountain Sport Jets was billed for 1.8 hours of use by invoice # 143 dated September 1, 2010 for the rate of \$610 per hour. P-20. Rocky Mountain Sport Jets was billed for 15.4 hours of use by invoice # 147 dated October 1, 2010 for the rate of \$610 per hour. P-20.

The evidence establishes that five of the 12 users were billed for flight hours without a written lease agreement in effect. This fact tends to prove that Petitioner did not operate as a leasing business. The preferential, below market rates charged to related persons (members and prospective members) also supports this conclusion. The overall character of Petitioner’s activities is that of a private aircraft owner seeking to share costs of ownership with others, rather

than a “leasing business” seeking to earn a profit from leasing the aircraft. This type of leasing activity is intended to offset some of the owner’s fixed costs by leasing it to others when an owner is not using it for personal or business purposes.

The number of hours that the aircraft was leased is relevant to this determination. In a case where a purported leasing business allows its sole asset to sit idle, it can hardly be said that the person is *engaged* in the business of leasing tangible personal property. A taxpayer may not lease property for a minimal number of hours, even at a market rate, and qualify as a “person engaged in the business of renting or leasing tangible personal property to others. . .” within the meaning of Rule 82. To the contrary, the leasing activity must be regular, systematic, and engaged in with the object of producing a net profit. Petitioner plausibly cites the economic recession of 2008 – 2009 and the bankruptcy of Eclipse Aviation to explain why it was unable to lease the aircraft for more hours. While there may be some truth to this argument, it is clear that Petitioner’s efforts to market and advertise the aircraft were insubstantial. The only media advertising was through Rocky Mountain Sport Jets, and the advertisements did not notify the public that the subject aircraft was available for dry leasing, but rather referenced partial ownership. The following table from the Findings of Fact section is reproduced here for purposes of analysis.

<u>Lessee</u>	<u>Hours of Use</u>	<u>Rate</u>	<u>Rental</u>
Jay Bielfield	2.6	500	1,300
Blair Mckendrick	7.2	500	3,600

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Fred Perenic	1.8	300	540
Richard A. Heidrich	167.9	300	50,370
Heidrich Aviation, LLC	4.3	300	1,290
isupply Partners, LLC	5	300	1,500
Jim Palmer ⁹	6.1	300	1,830
	3.1	600	1,860
Virchow, Krause & Co – Barry Lefkowitz	1.6	500	800
Richard Tool & Die Corporation ¹⁰	21.7	300	6,510
Rocky Mountain Sport Jets	17.2	610	10,492
Marc Schechter	12.5	300	3,750
Toledo Orthopedics – Tony Frogamini ¹¹	2.5	795	1,987.50
	<u>1</u>	<u>755.25</u>	<u>755.25</u>
	254.5		86,584.75

Total Use Tax @ 6% \$5,195.08 (based on invoices dated 3/1/2008 to 6/1/2011)

As borne out by the hours of use, the aircraft was acquired primarily for personal use by Mr. Heidrich and his business. Mr. Heidrich also desired to bring other members into the LCC as a cost-sharing mechanism. Of the 254.5 total hours use, 211.4 hours (83%) were attributable to related persons: Richard A. Heidrich, Richard Tool & Die Corporation, Marc Schechter, and

⁹Jim Palmer paid two different rates as indicated.

¹⁰ Mr. Heidrich was a member of isuppli Partners, LLC.

¹¹ Toledo Orthopedics paid two different rates. See, invoices #154 and #117. P-20.

isupply Partners, LLC (Mr. Heidrich was a partner of isupply Partners, LLC).

The leases (P-5, P-6 and P-7) were dry leases, meaning that the lessee bore expenses for pilots, fuel, landing fees, and any expenses incurred in operating the aircraft. TR 37:17.

Of the twelve lessees, six paid a rate greater than \$300 per hour: three paid \$500, and the others paid \$600, \$610, \$755.25, and \$795. Three apparently “unrelated” persons paid \$300 (Mr. Perenic for 1.8 hours of use, Mr. Palmer for 6.1 hours of use, and isupply Partners, LLC for 5 hours of use). Mr. Heidrich testified that this lower rate was given to Mr. Perenic and Mr. Palmer while they considered whether or not “to become a partner.” Apparently, when Mr. Palmer decided not to join the LLC, his rate was increased to \$600. The rationale offered for charging Mr. Heidrich and Mr. Schechter the lower rate is that as “partners” they carry the fixed costs and therefore should pay a lower rate. However, this does not explain why Richard Tool & Die Corporation or isupply Partners, LLC (not members of the LLC) paid a lower, non-market rate for use of the aircraft under identical dry leases.

These facts demonstrate that the market rate was in the range of \$500 to \$795 per hour, because unrelated persons were willing to pay that rate to lease the aircraft under identical lease provisions (or in some cases, with no written lease). It doesn’t follow that under arm’s length conditions the members of the LLC would pay a lower rate of only \$300 per hour. The fact that Petitioner was able to charge unrelated parties considerably more pursuant to identical leases

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demonstrates that the \$300 per hour rate given to members and related entities was below market and not arm's length. The terms of the lease agreements that are in evidence are identical, except for the different lease rates. There are three "related lessees" for whom a written lease is in evidence and invoices show the lease rate of \$300 per hour (Mr. Heidrich, Mr. Schechter, and Richard Tool & Die Corporation). Heidrich Aviation, LLC, was also issued an invoice for use of the subject aircraft at \$300 per hour. Three others leased the aircraft on a limited basis for \$300 per hour (Mr. Perenic, Mr. Palmer, and isupply Partners, LLC). The different lease rates for the members obscures the distinction between the LLC and the members and tends to prove that the members did not treat the LLC like a separate business entity.

From a use tax perspective this means that the lease receipts are artificially low, which results in use tax avoidance. Mr. Heidrich was far and away the major user of the aircraft, having leased it for 167.9 hours from February 2008 to June 2011, at \$300 per hour, with the total rentals of \$50,370. The use tax on that amount was \$3,022.20. If Mr. Heidrich had paid the \$600 per hour rate charged to several others, the use tax would be \$6,044.40. For all lessees that were charged the \$300 per hour rate, the total hours of use was 219.3 (for the period described above) and use tax attributable to those hours was \$3,947.40, which would have been twice that amount had the rate been \$600. In cases where the taxpayer has been found ineligible for the Rule 82 election, the courts have disallowed the election and imposed the tax on the entire price. *Masse v Treasury*, MTT Docket No. 100087 (1989). Petitioner cites no authority for a different result, such as imposing use tax upon the "market" rental rate rather than the actual rental receipts.

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The actual use from February 2008 to May 2011 (40 months) was 254.5 hours, for an average approximately 6.36 hours per month. Petitioner admits that this amount of leasing activity is considerably less than what would be desired by a leasing business, having ostensibly planned to lease it for up to 450 hours per year. Petitioner goes to great lengths attempting to prove that the reason that the \$195,000 in gross rents was not realized was due to the recession, the bankruptcy of Eclipse Aviation, and related problems, such as a shortage of parts and certified pilots.

Richard Tool & Die Corporation was also impacted by the recession and its business declined, which restricted travel by air. While these reasons are plausible, they are not credible, considering the totality of the circumstances, including the insubstantial efforts to market and advertise the aircraft for dry leasing. The below-market rate offered to selected persons also supports a conclusion that Petitioner was not engaged in the business of leasing aircraft to others.

In this case, Petitioner claimed an exemption from tax that would normally be due at the time the aircraft was brought to this state. This is permitted under the sales and use tax system because the rental receipts are also subject to use tax in the event sales or use tax is not paid up front. The law provides the taxpayer an election between two equivalent methods of remitting sales or use tax.

In the same manner that it is unlawful to report a below-market purchase price, it is also unlawful to elect to pay the tax on the rental receipts unless the taxpayer is legitimately engaged in the business of leasing aircraft to others. Here, Petitioner avoided use tax in the stipulated amount of \$67,230.76 by invoking the election under Rule 82. Instead, Petitioner remitted only \$2,651.85 in

use tax over 27 months, or an average of \$98 per month. At this rate, it would take 57 years to pay the tax that would have been due at the time of purchase.

Although both the members testified that the goal of Heidrich Aviation, LLC was to “make money” and to earn a profit, this does require a conclusion that Petitioner was “engaged in the business of leasing” aircraft to others within the meaning of Rule 82 and MCL 205.94(5). When the overall arrangement is viewed objectively and in context, these claims lack credibility. Perhaps there were certain businesslike aspects to the ownership and use of the aircraft, but overall, these facts are an example of a type of fractional ownership (joint ownership) coupled with minimal dry leasing with the goal to recover some of the member’s fixed costs. The testimony of Mr. Steven Cirino establishes that the advertisements were intended to attract new joint owners and not for leasing. TR 93-94. There is no evidence of a place of business from which the ostensible leasing activity was based. There is no evidence that Petitioner maintains a website offering the subject aircraft for dry leasing. The predominant character of Heidrich Aviation, Inc. is not that of a leasing business, but rather a joint ownership arrangement. Petitioner was not “engaged in the business of leasing” aircraft to others within the meaning of Rule 82 and MCL 205.94(5).

Judgment

IT IS ORDERED that assessment No. Q074792 is AFFIRMED in the stipulated amount of \$67,230, with statutory interest calculated under 1941 PA 122.

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IT IS FURTHER ORDERED that the penalty imposed under assessment No. Q074792 is hereby CANCELED.

IT IS FURTHER ORDERED that all use tax payments remitted on monthly rental receipts shall be credited toward payment of Final Assessment No. Q074792.

IT IS FURTHER ORDERED that the parties shall have 20 days from date of entry of this Proposed Opinion and Judgment to file exceptions and written arguments with the Tribunal consistent with Section 81 of the Administrative Procedures Act (MCL 24.281). The exceptions and written arguments shall be limited to the evidence admitted at the hearing. This Proposed Opinion and Judgment, together with any exceptions and written arguments, shall be considered by the Tribunal in arriving at a final decision in this matter pursuant to Section 26 of the Tax Tribunal Act (MCL 205.726).

MICHIGAN TAX TRIBUNAL

Entered: October 24, 2011

By: Thomas A. Halick