SC98409

IN THE SUPREME COURT OF MISSOURI

DIRECTOR OF REVENUE,

Appellant,

v.

APLUX LLC AND PAUL AND ANN LUX ASSOCIATES L.P.,

Respondent.

From the Administrative Hearing Commission
The Honorable Sreenivasa Rao Dandamudi

APPELLANT'S BRIEF

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JURISDICTIONAL STATEMENT

The decision by the Administrative Hearing Commission (AHC) is a final decision. Because that decision involves construction of the revenue laws, this Court has exclusive appellate jurisdiction. Mo. Const. art. V, § 3.

INTRODUCTION

The Missouri Department of Revenue issued assessments for unpaid consumer use tax for the purchase of two privately held airplanes—a 2011 Socata TBM 850 (TBM) and a 1999 Cessna 560XL (Excel) (collectively "the Aircraft")—to APLUX, LLC and one of its members Paul and Ann Lux Associates, L.P. (collectively "APLUX"). (Jt. Ex. 6). APLUX appealed to the Administrative Hearing Commission (AHC), which held a hearing on June 20, 2018. (L.F. 00043). APLUX claimed that its purchase of the TBM was exempt from consumer's use tax under § 144.018 as its subsequent lease of the TBM to its parent company, Luxco, Inc. (Luxco) satisfied the criteria of a sale for resale exemption.[1] (L.F. 00005-00008, 00054-00055). APLUX similarly claimed that its purchase of the Excel was exempt from consumer's use tax under § 144.018 and § 144.030 as its concurrent lease of the Excel to both Luxco and Aero Charter Inc., satisfied the criteria of a sale for resale exemption. (L.F. 00005-00008, 00054). APLUX remitted sales tax to the Department of Revenue based on the lease payments Luxco made to APLUX for the Aircraft during the assessed time period. (L.F. 00046). APLUX argued that, under the statutes in question, it had "the option of paying taxes either upon the purchase price or

[1] All statutory references are to RSMo Cum. Supp. 2011. While several of the cited statutes were amended during the assessed time period, all of the relevant language discussed herein remained the same.

the lease payments [from Luxco] without requiring taxes to be assessed on property…at the moment of its greatest value[.]" (L.F. 00008). *See* 12 CSR 10-108.700(3). (L.F. 00055). APLUX also concurrently leased the Excel, but not the TBM, to Aero Charter Inc. (Aero), a common carrier under the Federal Aviation Regulations. (L.F. 00048). Aero made payments to APLUX based on the number of hours it chartered the Excel and the parties' negotiated hourly rate. (L.F. 00048). APLUX did not report the lease payments from Aero on its sales tax return as required. § 144.655.4. However, the Director did not assess any liability for the payments from Aero because those payments fell under an exclusion from sales tax outlined in sections 144.018 and 144.030. *See Business Aviation, LLC v. Director of Revenue*, 579 S.W.3d 212 (Mo. banc 2019).

The AHC reversed the assessment of unpaid use tax on APLUX's purchases of the Aircraft relying on this Court's recent decision in *Business Aviation*. (L.F. 00043, 00068). The AHC found that APLUX's purchases of the Aircraft and subsequent leases to Luxco qualified for a resale exemption under § 144.018. (L.F. 00068). The AHC concluded that APLUX was not liable for use tax, additions to tax, or interest because its purchase of the TBM qualified for the sale for resale exemption under § 144.018, and APLUX properly remitted sales tax on the lease stream between itself and Luxco to the Department of Revenue for the TBM. (L.F. 00068). The AHC similarly concluded that APLUX's purchase of the Excel qualified for the sale for resale exemption

under § 144.018 for its lease to Luxco and alternatively under sections 144.030 and 144.615(3) for its lease to Aero. (L.F. 00068).

The Director seeks review of the AHC's decision reversing its assessment of consumer use tax on APLUX's purchase of the Aircraft. The parties' central issues are two-fold: (1) What constitutes a taxable use by an purchaser and owner of an aircraft for use tax purposes; and (2) whether an entity must transfer more than a mere non-exclusive license in order to qualify for the use tax exemption for resale purposes.

STATEMENT OF FACTS

In 2006, Donn Lux and Steve Soucy formed APLUX as a limited liability company with the sole business purposes of owning and leasing the Aircraft. (L.F. 00044). Mr. Lux was the CEO and chairman of the board of Luxco. (L.F. 00044). He owned 100% of the voting stock in Luxco and the non-voting shares were spread among various trusts in favor of Mr. Lux and his family members. (L.F. 00044). Luxco was a privately-owned, Missouri S-corporation that produced and marketed alcoholic beverages. (L.F. 00044). APLUX was a wholly-owned subsidiary of Luxco with Luxco as its only member after 2011.[2] (L.F. 00044). Mr. Lux executed contracts on behalf of both Luxco and APLUX. (L.F. 00045).

Mr. Lux was also a licensed pilot qualified to fly the TBM. (L.F. 00045). Throughout his ownership of the TBM, Mr. Lux periodically flew the plane as the pilot in command. (L.F. 00045). APLUX purchased the Aircraft for the sole purpose of leasing the Aircraft to Luxco on a non-exclusive basis. (L.F. 00045-00047). Mr. Lux executed lease agreements between Luxco and APLUX in which APLUX leased the Aircraft to Luxco for a non-negotiated yearly rate. (L.F. 00046-00050). Luxco advanced all of the money to purchase the Aircraft

[2] L.P. was the sole member of Aplux prior to its voluntary dissolution in 2011. L.P. was a Missouri limited partnership organized in 2004. (L.F. 00044). Its partners were Paul and Ann Lux, Donn Lux's parents. (L.F. 00044). Paul Lux passed away in 2005. (L.F. 00044).

to APLUX and made "payments" to APLUX on the lease via inter-company transfers. (L.F. 00046-00048). APLUX did not collect any actual money from Luxco for the Aircraft, including the sales tax that APLUX remitted to the Department of Revenue based on the lease payments. (L.F. 00046-00049). APLUX also entered into management agreements with Aero Charter Inc., a common carrier based out of the Spirit of St. Louis Airport in Chesterfield, Missouri, and paid Aero for the cost of storing, maintaining, and insuring the Aircraft. (L.F. 00045-00046).

A. Purchase of the Aircraft and Execution of Lease and Management Agreements

i. The TBM

On August 5, 2011, APLUX purchased the TBM from a company in Texas for $3,220,000 for the sole purpose of leasing the plane to Luxco. (L.F. 00045-00046). Luxco advanced APLUX the money to purchase the TBM from its operating account and corporate line of credit. (L.F. 00046). APLUX presented the seller a Texas sales tax exemption certificate stating that the TBM would not be used in Texas but would be hangared in Chesterfield, Missouri. (L.F. 00046). APLUX then leased the TBM to Luxco on August 15, 2011. (L.F. 00046). Under the terms of the lease between Luxco and APLUX, APLUX transferred the right to use the TBM to Luxco and, in exchange, Luxco agreed to pay APLUX $114,000 annually in rent. (L.F. 00046). The lease was non-

exclusive, and APLUX retained priority of use and operational control of the TBM when Luxco was not in operational control. (L.F. 00046, Jt. Ex. 11).

On August 15, 2011, APLUX and entered into an Aircraft Management Agreement with Aero Charter, Inc for the TBM.[3] (L.F. 00046). Under the terms of this agreement, Aero provided maintenance and hangar space for the TBM and ensured that the TBM was ready for operations. (L.F. 00046). In exchange, APLUX paid Aero for the maintenance, insurance, management, and hangar fees of the TBM. (L.F. 00046). Mr. Lux signed the Aircraft Management Agreement as manager for APLUX. (L.F. 00046). Luxco did not enter into a management agreement with Aero for the TBM until June 2012. (L.F. 00065). After the purchase of the TBM, only APLUX had an agreement with Aero and Aero billed APLUX and not Luxco for the flights Luxco chartered out of the Spirit of St. Louis Airport. (Jt. Ex. 16, 17, 19, and 38). After both agreements

[3] Aero Charter, Inc. (Aero) is a full-service private charter company based out of the Spirit of St. Louis Airport in Chesterfield, Missouri. (L.F. 00045). Aero maintains a U.S. Air Carrier Certificate issued by the Federal Aviation Administration under the Federal Aviation Regulations. (L.F. 00045). Aero was a common carrier in Missouri because Aero provided air charter transportation services to third parties under Part 135 of the Federal Aviation Regulations. (L.F. 00045); *See* § 144.030.2(20), 14 C.F.R. § 135.1, et. seq. Aero maintained a small fleet of leased aircraft available for charter to members of the public. (L.F. 00045). Aero entered into leases with the owners of the aircraft, provided maintenance services and fuel for the aircraft, and handled chartering the aircraft. (L.F. 00045).

were executed, Luxco took possession of the TBM and flew the TBM to Aero's hangar at the Spirit of St. Louis Airport in Chesterfield, Missouri. (L.F. 00046).

APLUX did not pay sales or consumer use tax on the purchase of the TBM. (L.F. 00046). APLUX remitted sales tax on the lease payments it received from Luxco. (L.F. 00046). Luxco recorded annual lease payments due to APLUX in its general ledger as inter-company transactions with any excess from lease payments over expenses returning to Luxco's line of credit. (L.F. 00047).

After it purchased the TBM, APLUX was the owner of the TBM. (L.F. 00047). APLUX did not operate or fly the TBM.[4] (L.F. 00047). Luxco had operational control over the TBM while operating Part 91 flights.[5] (L.F. 00047). Only Luxco, its personnel, or persons related to or friends with Luxco personnel, used the TBM for Part 91 flights, besides the Part 91 flights by Aero for maintenance and repositioning of the TBM. (L.F. 00047). The TBM was not under Aero's certificate for Part 135 flights, meaning that it could not be used

[4] As discussed infra, the Director disagrees with the AHC's finding and conclusion that APLUX did not "use" the TBM. (L.F. 00047).

[5] Part 91 flights are not for hire or non-charter flights under the Federal Aviation Regulations. (L.F. 00047). These flights include flights for maintenance and repositioning the aircraft. (L.F. 00047). If an aircraft's owner flew the aircraft, Aero categorized it as a Part 91 flight. (L.F. 00047).

for charter flights by Aero. (L.F. 00047). Aero considered the titleholder of the TBM (APLUX) and the lessee (Luxco) to be its owners. (L.F. 00047).

ii. The Excel

On January 5, 2012, APLUX purchased the Excel in Kansas for $3,150,000 for the sole purpose of leasing the plane to Luxco and Aero. (L.F. 00047). APLUX provided the seller with a Kansas sales tax exemption certificate and Luxco advanced the money to APLUX to purchase the aircraft from its operating account and corporate line of credit. (L.F. 00047-00048). After the purchase was complete, APLUX executed a non-exclusive dry lease agreement for the Excel with Aero. (L.F. 00048). Under this lease agreement, APLUX transferred the right to use the Excel to Aero for charter flights, but reserved priority of use to itself. (L.F. 00048, Jt. Ex. 15, 19). In exchange, Aero agreed to pay rent to APLUX each month based on the number of hours that Aero chartered the Excel under Part 135 of the Federal Aviation Regulations at the rate of $1,450 per flight hour. (L.F. 00048). Aero was not initially required to charter the aircraft for a minimum number of hours each month, and Aero was only responsible for remitting the charter usage fee to APLUX for actual charter flight hours flown. (Jt. Ex. 15, 19). Under the initial lease, Aero was only required to exercise reasonable commercial efforts to charter the aircraft. (Jt. Ex. 15, Jt. Ex. 19).

APLUX and Aero also amended their existing management agreement to cover the Excel. (L.F. 00048). Aero provided management, maintenance, insurance, and hangar space for the Excel, which were paid by APLUX. (L.F. 00048).

If the lease income for chartered flights of the Excel exceeded the amount APLUX owed to Aero under the management agreement, Aero would send a check to APLUX for the amount of lease income minus expenses. (L.F. 00049). But Aero would often bill or credit Luxco and APLUX interchangeably as it did not understand the business relationships between APLUX, Luxco, and Mr. Lux. (L.F. 00049-00050).

On February 1, 2012, APLUX entered into a concurrent, non-exclusive dry lease agreement with Luxco for the Excel and TBM. (L.F. 00048). Under this agreement, APLUX transferred the right to use the Excel to Luxco, and in exchange, Luxco agreed to pay rent in the amount of $117,600 annually to APLUX. (L.F. 00048). The terms regarding the TBM remained the same. (L.F. 00048).

After APLUX purchased the Excel it did not pay sales tax or use tax on the purchase. (L.F. 00049). Instead, APLUX remitted sales tax on the lease payments from Luxco. (L.F. 00049). After the purchase of the Excel, APLUX owned the plane but APLUX did not operate or fly the Excel. (L.F. 00049). APLUX leased the Excel to Aero and Luxco concurrently, and APLUX, Luxco,

and Aero had operational control over the Excel. (L.F. 00049). Aero chartered the Excel under Part 135 flights and Luxco used the Excel for Part 91 flights when it was not already chartered by Aero. (L.F. 00049). While Aero determined the charter fee for Part 135 flights for the Excel, the accountants and attorneys for Luxco set the amount of lease fees in the leases between APLUX, Aero, and Luxco. (L.F. 00050).

After the purchase of the Aircraft, both planes had Luxco's company logos painted on the tails and Luxco personnel considered the Aircraft to be leased corporate aircraft. (L.F. 00050). Mr. Lux and his family members and friends scheduled private charters, under Part 91 flights, through Aero under sublease agreements between APLUX and Luxco for the Aircraft. (L.F. 00050). Mr. Lux would pay Luxco, not APLUX, for his personal flights. (L.F. 00050). Luxco contacted Aero to schedule flights for both Aircraft and Aero would code the Luxco Part 91 flights differently on Aero's statements to Luxco or APLUX. (L.F. 00050). Some of the passengers on these private charter flights would reimburse APLUX for expenses with checks payable to and deposited by APLUX. (L.F. 00050). APLUX did not collect or remit sales tax on these lease payments which were separate from the rental amount paid by Luxco to APLUX. (J. Ex. 14). Although Luxco did not enter into independent service agreements with Aero to provide services to support Luxco's operation of the

Aircraft for Part 91 flights, Aero provided such services to Luxco after Luxco entered its leases with APLUX. (L.F. 00053).

In July 2013, Luxco entered into Aircraft Time Sharing Agreements for the TBM and the Excel with various individuals within or related to the Lux family. (L.F. 00050).

B. The Lease Agreements

The following provisions were contained in both the lease agreements between APLUX and Luxco for the TBM and the TBM/Excel:

> Lease. Lessor [APLUX] agrees to lease to Lessee [Luxco], and Lessee agrees to lease from Lessor, the Aircraft, on the terms and conditions of this Agreement which shall govern each lease and use of the Aircraft by the Lessee. *Lessee acknowledges that except during the period that Lessee has possession of the Aircraft, Lessee will have no right to use, possess, or otherwise have access to the Aircraft. Lessee further acknowledges that Lessee does not, and will not at any time, have a priority or preference to use, possess or lease the Aircraft over any other person.*
>
> Non-Exclusivity.
> (a) *Lessee and Lessor acknowledge that the Aircraft is leased to Lessee on a non-exclusive basis, and that the Aircraft shall, at other times, be operated by Lessor and may be otherwise subject to lease to others during the Term*.
> (b) In no event shall Lessor be liable to Lessee for unavailability of the Aircraft, or any loss of use thereof, or damages or costs resulting therefrom, for any reason whatsoever, including by reason of any scheduled or unscheduled inspections, maintenance or repair of the Aircraft, or any delays in completion thereof.
>
> Scheduling. Lessee's use of the Aircraft during the Term of this Agreement is non-exclusive. The parties agree as follows:
> (a) Use by Other Lessees. Lessor and Lessee agree that Lessor may lease the Aircraft to one or more other lessees during the Term on

a non-exclusive basis, that *Lessor has the absolute right to determine the availability of the Aircraft for Lessee and the Lessor's use of the Aircraft shall have priority over the availability of the Aircraft for lease to Lessee or any other party*. Lessor agrees that at such time as the Aircraft is not undergoing maintenance or being used by Lessor, Lessee and all other lessees of the Aircraft shall be scheduled on a "first come, first served" basis; provided, however, that Lessee and all other lessees shall cooperate in good faith on all scheduling matter and shall use their respective best efforts to avoid scheduling conflicts involving the Aircraft.

Title and Registration. Title to the Aircraft shall remain vested in Lessor at all times during the Term to the exclusion of Lessee and Lessor shall have only such rights as shall be specifically set forth herein. Lessor represents that as of the date of this Agreement the Aircraft is, and throughout the Term the Aircraft shall remain, lawfully registered in Lessor's name as a civil aircraft of the United States.

Use and Operation. Except as otherwise expressly provided herein, Lessee shall be solely and exclusively responsible for the use, and operation and control of the Aircraft during each period of the Term commencing when the Aircraft has been delivered to Lessee and terminating when the Aircraft has been returned to the Lessor in the condition required hereunder.

Operational Control. THE PARTIES EXPRESSLY AGREE THAT LESSEE SHALL AT ALL TIMES WHILE THE AIRCRAFT IS IN ITS POSSESSION DURING THE TERM MAINTAIN OPERATIONAL CONTROL OF THE AIRCRAFT, AND THAT THE INTENT OF THE PARTIES IS THAT THIS AGREEMENT CONSTITUTES A "DRY" OPERATING LEASE.[6]

See Jt. Ex. 11, 12, and 13. (emphasis added).

[6] According to the leases, "'Operational Control' has the same meaning given the term in Section 1.1. of the Federal Aviation Regulations." (L.F. 00052) (quoting Jt. Ex. 11 at 1.10, Jt. Ex. 13 at 1.7). The Federal Aviation Association defines "operational control" as "the exercise of authority over initiating, conducting or terminating a flight." (L.F. 00052) (quoting 14 C.F.R. § 1.1).

The lease between APLUX and Aero for the Excel defined APLUX as the "Owner" and Aero as the "Operator." It stated that:

> Each operation of the Aircraft by Owner or a lessee of the Aircraft, other than Operator, including all maintenance flights, training flights, ferry or positioning flights to accommodate Owner or Owner's lessee's operation of the Aircraft, or other similar flights during which the Aircraft is not being operated by Operator as a Charter Flight (each, an "Owner Flight") shall be conducted in accordance with FAR Part 91 and as such may not involve the provision of air transportation for any kind of compensation or reimbursement, except as might be permitted by FAR Part 91.501. Nothing contained in this Agreement is intended or should be constructed to grant Owner or Owner's lessee (a) any authority to conduct flight operations under FAR Part 135 or (b) any control over a Charter Flight.
>
> Scheduling of Charter Flights. Operator shall arrange, schedule and dispatch all Charter Flights. Operator may use and operate the Aircraft for a Charter Flight at any time during the Term without the prior consent or approval of Owner, provided Owner has not previously scheduled the Aircraft for the same time interval. Owner retains scheduling priority for Owner Flights throughout the Term, provided Owner Flight does not interfere with a previously scheduled Charter Flight.

See Jt. Ex. 15, 19.

Under the APLUX/Aero Management agreements for the Aircraft, APLUX and Aero agreed that APLUX "will have and shall exercise Operational Control over each use of the Aircraft by" APLUX. (L.F. 00053) (quoting Jt. Ex. 17 at 2.4; Jt. Ex. 19).

APLUX did not pay use tax on the purchase of either the TBM or the Excel, but remitted sales tax on the lease payments it received from Luxco for

the Aircraft. (L.F. 00046, 00049). Luxco reported federal income tax on its consolidated return for Luxco and its four subsidiaries, including APLUX. (L.F. 00045). APLUX reported the depreciation of the Aircraft on its consolidated return with Luxco. (L.F. 00045).

C. The Audit and the Appeal to the AHC

The Director of Revenue ("Director") conducted a tax audit of APLUX, examining the period beginning October 1, 2009, and ending April 30, 2015, for sales tax, and ending September 30, 2014, for use and withholding tax. (L.F. 00053). The Director determined that APLUX was not in the business of leasing aircraft and that there was not an arms-length transaction between APLUX and Luxco. (L.F. 00054).

On August 21, 2015, the Director assessed APLUX $136,045 in use tax, $6,802.25 in additions to tax, and $13,140.77 in interest for the third quarter tax period of 2011 (July 1, 2011-September 30, 2011). (L.F. 00054). The Director credited APLUX with $59,665.68 for the sales tax remitted on the payments paid by Luxco under the lease during this time period. (L.F. 00054). The resulting assessment balance due to the Director was $96,322.34. (L.F. 00054). Additionally, the Director assessed APLUX $97,734.81 in use tax, $4,886.74 in additions to tax, and $10,180.47 in interest during the first quarter of 2012 (January 1- March 31, 2012). (L.F. 00054). While the Director did not assess APLUX for any sales tax on payments made by Aero to APLUX

for the Excel, APLUX was still required to report this income on its gross receipts. *See* §§ 144.021, 144.080.1(8), 144.100, and 12 CSR 10-103.555. (A seller is required to collect the tax from the purchase of the taxable personal property and is required to report all of its gross receipts, even if exempt from tax).

On October 20, 2015, APLUX filed a petition with the Administrative Hearing Commission ("AHC") challenging the Director's assessments. (L.F. 00043). A hearing was held before the AHC on June 20, 2018, and the AHC issued its findings and conclusions on February 10, 2020. (L.F. 00043, 00068).

The AHC found that APLUX was in the business of leasing aircraft and had purchased both Aircraft solely to resell them to Luxco or to Luxco and Aero. (L.F. 00045-00047). The AHC further found that the leases between APLUX and Luxco were not disingenuous; the leases transferred the right to use the Aircraft from APLUX to Luxco; that APLUX did not "use" the Aircraft; and that Luxco and not APLUX had operational control over the Aircraft. (L.F. 00053-00068). As discussed *infra*, the Director is appealing these specific findings and conclusions of the AHC.

The AHC concluded that APLUX did not owe use tax on its out-of-state purchases of the Aircraft because it had purchased them for resale by lease under § 144.018, and the remission of sales tax on the lease payments Luxco made to APLUX was a proper election. (L.F. 00053-00068).

STANDARD OF REVIEW

A decision of the AHC must be affirmed if "(1) it is authorized by law; (2) it is supported by competent and substantial evidence on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the General Assembly." *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 435-436 (Mo. banc 2010); § 621.193, RSMo; *Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118, 121 (Mo. banc 2014). This Court reviews the Commission's interpretation of revenue statutes *de novo*. *Brinker Mo., Inc.*, 433 S.W.3d at 435. Exemptions are strictly construed against the taxpayer, "and any doubt must be resolved in favor of application of the tax." *Emerson Elec. Co., v. Dir. of Revenue*, 204 S.W.3d 642, 645 (Mo. banc 2006); *Bartlett Int'l, Inc. v. Dir. of Revenue*, 487 S.W.3d 470, 472 (Mo. banc 2016). The taxpayer bears the burden of proving that "an exemption applies 'by clear and unequivocal proof[.]'" *TracFone Wireless, Inc. v. Dir. of Revenue*, 514 S.W.3d 18, 21 (Mo. banc 2017). "In interpreting a statute, this Court's primary responsibility is to "ascertain the intent of the legislature from the language used" and to give effect to that intent." *Alberici Constructors, Inc. v. Dir. of Revenue,* 452 S.W.3d 632, 636 (Mo. banc 2015).

POINTS RELIED ON

I. The Administrative Hearing Commission erred in holding that APLUX was entitled to a use tax exemption on two purchased aircraft, because APLUX exercised taxable use of the aircraft within the meaning of sections 144.018, 144.605, and 144.615, in that operational control of both aircraft rested with APLUX where the aircraft were non-exclusively leased, one to a parent company and the other to a parent company and to a common carrier concurrently, and APLUX reserved for itself priority of use and otherwise maintained control over the aircraft.

Business Aviation, LLC v. Director of Revenue, 579 S.W.3d 212 (Mo. banc 2019)

DI Supply I, LLC v. Director of Revenue, 601 S.W.3d 195 (Mo. banc 2020)

§ 144.018

§ 144.030

§ 144.605

§ 144.615

II. The administrative hearing commission erred in holding that APLUX was entitled to a use tax exemption on two purchased aircraft, because the economic and substantive realities of the transactions show that the aircraft were not purchased for resale, in that many of the formalities normally expected in an aircraft leasing transaction were replaced by inter-company transactions, APLUX was not a financially viable business, and there is no evidence that the leases were actually negotiated.

Central Cooling & Supply Co. v. Dir. of Revenue, 648 S.W.2d 546 (Mo. banc 1982)

Gregory v. Helvering, 293 U.S. 465 (1935)

Higgins v. Smith, 308 U.S. 473 (1940)

Loren Cook Co. v. Dir. of Revenue, 414 S.W.3d 451 (Mo. banc 2013)

ARGUMENT

I. The Administrative Hearing Commission erred in holding that APLUX was entitled to a use tax exemption on two purchased aircraft, because APLUX exercised taxable use of the aircraft within the meaning of sections 144.018, 144.605, and 144.615, in that operational control of both aircraft rested with APLUX where the aircraft were non-exclusively leased, one to a parent company and the other to a parent company and to a common carrier concurrently, and APLUX reserved for itself priority of use and otherwise maintained control over the aircraft.

The AHC erred in finding that APLUX's purchase of the Aircraft qualified for a sale for resale exemption from use tax. First, there was not a transfer of the right to use the Aircraft under the leases. There was the transfer of a non-exclusive license to use the Aircraft to two lessees concurrently. Second, APLUX exercised significant control over the Aircraft by reserving the right to use the Aircraft over each lessee, maintaining operational control when the Aircraft were not in actual use by either lessee, and by otherwise acting as the owner of the Aircraft. Because APLUX exercised such control over the purchased assets, it did not qualify for the sale for resale exemption because the exemption is for purchasers in the ordinary course of business who do not partially transfer the right to use the property. Simply put, a lease agreement

transferring a non-exclusive license to use tangible personal property, subject to the owner's prioritized use of that property, is not a "sale" for purposes of the resale exemption under the Use Tax Law.

A. Applicable Law

Section 144.610 imposes a use tax on out-of-state purchases "for the privilege of storing, using or consuming within this state any article of tangible personal property." *President Casino, Inc. v. Dir. of Revenue*, 219 S.W.3d 235, 237-238 (Mo. banc 2007) (quoting § 144.610.01); *see Fall Creek Const. Co. v. Dir. of Revenue*, 109 S.W.3d 165, 169 (Mo. banc 2003). Use tax is imposed at the time the property "has finally come to rest within this state or until the article has become commingled with the general mass of property of this state." § 144.610.1. Unless relieved by a vendor collecting the tax, all purchasers are required to file a return and to pay use tax on all taxable purchases. §§ 144.610.1 and 144.655.4. Section 144.020.1(8) imposes "a tax equivalent to four percent of the amount paid or charged for rental or lease of tangible personal property" unless the purchaser made a "sale at retail" purchase as defined in § 144.010 and paid the tax at the time of purchase.[7]

[7] "'Sale at retail' means any transfer made by any person engaged in business as defined herein of the ownership of, or title to, tangible personal property to the purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration[.]" § 144.010(11).

A "purchase" is defined as "the acquisition of the ownership of, or title to, tangible personal property, through a sale, as herein defined, for the purpose of storage, use or consumption in this state." § 144.605(5). For use tax, a "sale" is defined as "any transfer, barter or exchange of the title or ownership of tangible personal property, or the right to use, store or consume the same, for a consideration paid or to be paid[.]" § 144.605(7). Sales include "any transactions whether called leases…or otherwise, and notwithstanding that the title or possession of the property is retained for security." *Id*. Sales tax has a different but similar definition for "sale" which is:

> "Sale" or "sales" includes installment and credit sales, and the exchange of properties as well as the sale thereof for money, every closed transaction constituting a sale, and means any transfer, exchange or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for valuable consideration and the rendering, furnishing or selling for a valuable consideration any of the substances, things and services herein designated and defined as taxable under the terms of sections 144.010 to 144.525[.]

§ 144.010.1(10)).[8] Under 12 CSR 10-108.700(2)(A) a "lease" is defined as "any transfer of the right to possess or use tangible personal property for a term in exchange for consideration."

[8] This definition is distinct from "sale at retail" under § 144.010.1(11) and from the definition of "sale" under § 144.605. *See DI Supply I, LLC v. Director of Revenue*, 601 S.W.3d 195, 197 (Mo. banc 2020) (abrogating prior case law applying the use tax definition of sale in sales tax cases and holding that "the sales tax and use tax resale exclusions derive from separate and distinct statutes requiring independent analysis, and application of the statutorily

Tangible personal property is defined as "all items subject to the Missouri sales tax as provided in subdivisions (1) and (3) of section 144.020." § 144.605(11). "An aircraft is an item subject to Missouri sales tax as tangible personal property." *Five Delta Alpha, LLC v. Dir. of Revenue,* 458 S.W.3d 818, 821 (Mo. banc 2015) (abrogated on other grounds by *Business Aviation LLC v. Director of Revenue*, 579 S.W.3d 212 (Mo. banc 2019)).

There are exemptions from sales tax and use tax for property that is purchased for the purpose of being resold (the "resale exemption"). *See President Casino*, 219 S.W.3d at 238. The purpose of this exemption is to "avoid multiple taxation of the same property as it passes through the chain of commerce from producer to wholesaler to distributor to retailer." *Id*. (quoting *Sipco, Inc. v. Director of Revenue*, 875 S.W.2d 539, 541 (Mo. banc 1994) (abrogated on other grounds by *DI Supply I*, 601 S.W.3d at 197)). The statutory resale exemption requirements are set forth in § 144.615(6) for use tax and the statutory resale exclusion for in-state transactions is set forth in § 144.010.1(11) for sales tax. *President Casino*, 219 S.W.3d at 238.

B. The Assessment and the AHC's Decision

The Director assessed use tax against APLUX and its members for APLUX's purchase of the Aircraft after finding that APLUX did not qualify for

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correct exemption requires application of the sales tax exemption in this sales tax case.").

any of the exemptions in sections 144.018, 144.030, and 144.615. The AHC reversed this assessment, finding that the lease of the Aircraft from APLUX to Luxco met the requirements for the sale for resale exemption in § 144.018, and, alternatively, that the lease of the Excel specifically met the requirements for the sale for resale exemption in sections 144.018.1(4), 144.615(3), and 144.030.2(20). (L.F. 00068).

The AHC relied on this Court's recent holding in *Business Aviation* to find that the leases transferred the right to use the Aircraft from APLUX to Luxco. In *Business Aviation*, Business Aviation was a limited liability company that purchased an airplane and then exclusively leased it to Burgess Aircraft Management LLC, a common carrier. 579 S.W.3d at 214. This Court found that the purchase of this airplane was exempt from use tax under the sale for resale exemption because the airplane was leased to a common carrier and there was a specific exemption from use tax for common carriers. *Id*. at 216-218 (citing §§ 144.018.1(4), 144.615(3), and 144.030)).

This Court found that "the right to use [the Airplane] was transferred because 'Business Aviation transferred complete operational and maintenance control of the [aircraft] to Burgess.'" *Id*. at 218. This Court further noted that under the lease agreement, the common carrier was given "the exclusive care, custody and control of the Aircraft during the term of [the Lease] and at all times during any Part 135 charter operations conducted by [Burgess]." *Id*.

Every time the aircraft was flown the common carrier "maintained exclusive custody and control." *Id*. When the aircraft was not in use it was stored at the common carrier's facility. *Id*. Based on these facts, this Court found that "Business Aviation transferred the exercise of right and power over the aircraft." *Id*.

Here, the AHC noted that APLUX chose not to exercise operational control or priority of use at any point during the assessed period. (L.F. 00062, 00066). The AHC examined the lease provisions cited by the parties and concluded that APLUX "did not retain custody or control over the Aircraft and, thus, the right to use the Aircraft was transferred from APLUX to Luxco and Aero." (L.F. 00067). This conclusion relied on the Supreme Court's language in *Business Aviation*, in which the court stated, "[C]hapter 144 and precedent do not require that the right to use be fully transferred." (L.F. 00068) (citing 579 S.W.3d at 218 n.10). However, the AHC was wrong to analyze the leases here as synonymous with the lease in *Business Aviation* because the lease agreements at issue conveyed a non-exclusive license to use the Aircraft when APLUX was not using it. It is irrelevant that APLUX did not elect to operate the Aircraft during the assessed time period. The lease provisions gave APLUX priority of use and reserved other rights over the Aircraft and this constituted "use" for the purposes of Use Tax Law. "Use" is defined as "the exercise of any right or power over tangible personal property incident to ownership or control

of that property…" § 144.605(13). Here, as discussed below, APLUX retained the exercise of significant rights and power over the Aircraft that were incident to ownership and control over the property including the right to use it, operational control when not in use on a Part 91 flight, the right to lease it to other entities, the right to subject its value as lien or collateral, the right to take its value and depreciate it, the right to control what kind of flights it went on, etc.

C. APLUX Exercised Taxable Use Over the Aircraft

i. The TBM

Here, there are several key differences from the facts and lease at issue in *Business Aviation* that demonstrate that APLUX maintained and exercised taxable use over the Aircraft and that the TBM lease between APLUX and Luxco did not transfer the right to use the Aircraft in the same manner as the lease in *Business Aviation*.

First, the lease in *Business Aviation* was an exclusive lease to a common carrier. 579 S.W.3d at 218. Here, the TBM was leased non-exclusively to APLUX's parent company, Luxco. (L.F. 00045-00047). Second, the lessee in *Business Aviation* had operational control over the airplane and exclusive possession of it when it was not in use. 579 S.W.3d at 216-218. Here, APLUX retained operational control and priority of use of the Aircraft when it was not being operated on a Part 91 flight by Luxco. (Jt. Ex. 11, 13). The lease

provisions make clear that APLUX, not Luxco, maintained operational control over the TBM when it was not in use. (Jt. Ex. 11, 13). Operational control is defined as "the exercise of authority over initiating, conducting or terminating a flight." (L.F. 00052) (quoting 14 C.F.R. § 1.1). Therefore, outside Luxco's Part 91 scheduled flights, the plane was under the operational control of APLUX. APLUX's decision to not fly the plane during the assessed time period has no bearing on the fact that it reserved the right to do so. Additionally, under the APLUX/Aero Management agreements for the Aircraft, APLUX and Aero agreed that APLUX "will have and shall exercise Operational Control over each use of the Aircraft by" APLUX. (L.F. 00059-00061) (quoting Jt. Ex. 17 at 2.4; Jt. Ex. 19).

The AHC found that Luxco maintained operational control over the TBM from the time it took possession of it until the end of the lease term, citing the lease provisions "Use and Operation and Operational Control." (L.F. 00060-00061). However, this presumes that Luxco was in continuous possession of the TBM and the record demonstrates that it was not. Aero would assume operational control over the TBM for repositioning or maintenance flights under its management agreement with APLUX. (Jt. Ex. 15, 19, L.F. 00047).

Additionally, Luxco did not have an independent management agreement with Aero during the assessed time period (L.F. 00065). Therefore, outside the time that the TBM was in flight under Part 91 for Luxco it was not

under operational control or in possession of Luxco. When it remained hangared at Aero, the TBM it was under the operational control of APLUX per the Management Agreement between APLUX and Aero. (L.F. 00053, Jt. Ex. 17 at 2.4; Jt. Ex. 19).

APLUX further exerted control over the TBM by entering into a management agreements with Aero for its maintenance and by paying for its maintenance and hangar fees and insurance. (L.F. 00046). In *Business Aviation*, the lessee "was to pay all costs for maintenance, insurance, management, cleaning, and repairs, as well as the hangar fees." 579 S.W.3d at 215.

Thus, unlike the transfer of the right to use the airplane in *Business Aviation*, in which the lessee had the exclusive right to operate the airplane, had sole possession of it during the assessed time period, paid for the management, maintenance and insurance costs, and could charter the plane out in the course of its business, here, the lessor retained operational control over the TBM when it was not in use by the lessee, reserved the right to use the TBM over the lessee, paid for all of the maintenance, management, and insurance costs of the TBM, retained sole ability to enter into contracts involving the TBM, and otherwise exercised rights incident to the ownership or control of the property. Therefore, APLUX maintained close to the entire bundle of rights of property ownership, and merely granted a single entity a

non-exclusive license (or a partial right) to use the TBM. APLUX retained priority of use and scheduling over Luxco and all other rights associated with the TBM, and is thus liable for use tax.

ii. The Excel

Almost the same lease provisions governed the Excel lease agreement between APLUX and Luxco as were discussed above. Therefore, Appellant adopts the same argument here as above, that APLUX and not Luxco maintained operational control over the Excel when it was not otherwise in use by the lessees, and that APLUX reserved priority of use for itself, and exercised rights incident to the ownership or control over the Excel (i.e. directing kinds of flights Aero could use the Excel on, and who could pilot the Excel for Aero). APLUX retained significantly more control over the Excel than the lessor in *Business Aviation*.

In *Business Aviation*, the lessee was the sole lessee and was allowed under the lease to charter the airplane with whomever they wished, whenever they wished. 579 S.W.3d at 215, 218. Additionally, the lessee maintained sole operational control, possession, and maintenance, of the airplane. *Id*. Under the terms of the lease at issue here, there were two lessees, Luxco and Excel, who did not have the ability to charter the plane with whomever they wished. When Aero asked about operating the Excel for short-leg flights, Donn Lux stated that he did not want the plane to go on them because of wear and tear.

(Tr. 133-134). The lessor paid for maintenance, possession was split amongst the lessees and lessor, and the lessor maintained all authority to enter the Excel into other leases or contracts or liens, and under the lease provisions APLUX maintained priority of use and scheduling over the Excel.

Thus the AHC's conclusion that APLUX "did not retain custody or control over the Aircraft and, thus the right to use the Aircraft was transferred from APLUX to Luxco and Aero" was incorrect. (L.F. 00067). APLUX retained significant control and reserved the right to use the Aircraft over all other entities. The AHC's conclusion that there was a transfer of the right to use the Aircraft that qualified for the sale for resale tax exemption should be reversed by this Court. While the right to use the Aircraft does not have to be fully transferred, this Court should find that merely granting multiple lessees non-exclusive licenses does not meet the minimum transfer requirements to qualify for the exemption. When a business entity, like APLUX, maintains all other aspects of use and ownership, it has not met the requirements for the sale for resale exemption. *See Business Aviation*, 579 S.W.3d at 218.

D. APLUX did not meet the qualifications of the use tax sale for resale exemption

The Missouri Supreme Court "seeks to give effect to legislative intent as expressed in the plain language of the statute" in tax cases. *Bartlett Int'l, Inc. v. Director of Revenue*, 487 S.W.3d 470, 472 (Mo. banc 2016) (citing *Akins v.*

Director of Revenue, 303 S.W.3d 563, 565 (Mo. banc 2010)). Different provisions of the tax code apply to sales tax and use tax. *DI Supply*, 601 S.W.3d at 197.

> The use tax complements the sales tax by creating "equality of taxation" among products purchased within and without the state. *Farm & Home Sav. Ass'n v. Spradling,* 538 S.W.2d 313, 317 (Mo.1976). In imposing a use tax, the legislature sought to "protect Missouri revenue and Missouri sellers against competition from out-of-state sellers by removing any advantage which might be gained by making purchases outside the state, on which no sales tax is collected." *R & M Enters., Inc. v. Director of Revenue,* 748 S.W.2d 171, 172 (Mo. banc 1988).

Sw. Bell Yellow Pages, Inc. v. Director Of Revenue, 94 S.W.3d 388, 392 (Mo. banc 2002). Thus, the use tax is meant to complement the sales tax code. *See* § 144.600 ("This law may be cited as the 'Compensating Use Tax Law.'"). For use tax resale exemptions the applicable statute is found within this section of the tax code and is § 144.615. *See DI Supply I*, 601 S.W.3d at 197; *Five Delta Alpha*, 458 S.W.3d at 821.

Section 144.018.1 provides:

> "Notwithstanding any other provision of law to the contrary, except as provided under subsection 2 or 3 of this section, when a purchase of tangible personal property or service subject to tax is made for the purpose of resale, such purpose shall be either exempt or excluded under this chapter if the subsequent sale is:
>
> (1) Subject to a tax in this or any other state;
> (2) For resale;
> (3) Excluded from tax under this chapter;
> (4) Subject to tax but exempt under this chapter; or
> (5) Exempt from the sales tax laws of another state, if the subsequent sale is in such other state.
>
> …

> 4. The provisions of this section are intended to reject and abrogate earlier case law interpretations of the state's sales and use tax law with regard to sales for resale as extended in *Music City Centre Management, LLC v. Director of Revenue*, 295 S.W.3d 465, (Mo. 2009) and *ICC Management, Inc. v. Director of Revenue*, 290 S.W.3d 699 (Mo. 2009). The provisions of this section are intended to clarity the exemption or exclusion of purchases for resale from sales and use taxes as originally enacted in this chapter.

An airplane is tangible personal property and is subject to use tax under § 144.610 unless an exemption is claimed and applied. Here, APLUX asserted that the purchase of the Aircraft was made for the purpose of a resale and should be excluded under the interplay between 144.018.1(4). (L.F. 00054). The AHC found that the purchase of the Aircraft qualified for the sale for resale exclusion for the same reasons discussed by this Court in *Business Aviation*. (L.F. 00057). However, the exemption discussed in *Business Aviation* was limited to leases to common carriers. 579 S.W.3d at 216-218. (citing §§ 144.018.1(4), 144.030.2(20), and 144.615(3)). The applicable sale for resale exemption for use tax for the leases at issue here is found in § 144.615(6).

Section 144.615 addresses the use tax exemption for resales. *DI Supply I*, 601 S.W.3d at 197; *Five Delta Alpha*, 458 S.W.3d at 821. It provides that:

> There are specifically exempted from the taxes levied in sections 144.600 to 144.745:
>
> …
>
> (3) Tangible personal property, the sale or other transfer of which, if made in this state, would be exempt from or not subject to the

> Missouri sales tax pursuant to the provisions of subsection 2 of section 144.030;
>
> …
>
> (6) Tangible personal property held by processors, retailers, importers, manufacturers, wholesalers, or jobbers solely for resale in the regular course of business[.].

Section 144.030.2 contains specific exemptions from use tax and sales tax including "[a]ll sales of aircraft to common carriers for storage or for use in interstate commerce[.] § 144.030.2(20). The only payments that would fall under § 144.615(3) would be those made by Aero to APLUX on the Excel. *See Business Aviation*, 579 S.W.3d at 216. The Director did not assess any liability to APLUX for the payments made to APLUX from Aero. The AHC correctly found that Luxco is not a common carrier. (L.F. 00055). Thus, this exemption cannot be applied to the lease payments from Luxco to APLUX.

The requirements of the use tax resale exemption are set out in § 144.615(6) which states that the taxable property at issue must be "held by processors, retailers, importers, manufacturers, wholesalers, or jobbers solely for resale in the regular course of business." Here, APLUX was not a processor, retailer, importer, manufacturer, wholesaler, or jobber, and APLUX did not hold the property solely for resale in the regular course of business. Instead, it gave a non-exclusive license to its parent company, and reserved the right to use the Aircraft for itself. A company should not be allowed to evade tax by

simply purchasing tangible personal property out-of-state, claiming a resale exemption, and entering into a "lease" agreement where all that is transferred is a non-exclusive limited license.[9]

Permitting the exemption here allows the end consumer to avoid paying use tax by creating a "chain" of transactions. Here, Luxco was the end consumer, and it purchased the tangible personal property using a wholly-owned subsidiary and then leased the property to itself Luxco was then able to set the price on the lease of the property and thus determined its own tax liability. Under such a hypothetical, an end consumer can avoid paying use tax on virtually any item purchased—effectively allowing the sale for resale exemption to swallow the rule that the end consumer must pay use tax on tangible personal property that is subject to tax. This produces an absurd and unreasonable result. *See Murray v. Missouri Highway and Transp. Comm'n*, 37 S.W.3d 228, 233 (Mo. banc 2001) (holding that statutes should be construed so as to avoid unreasonable and absurd results).

[9] For example, suppose Company A purchases a forklift that it intends to use for a non-exempt purpose such as moving merchandise around in its retail store. Company A purchases the forklift out of state, claims a resale exemption, and then enters into a "lease" agreement with Company B, a manufacturer (lease receipts exempt under 144.030 and 144.054 if used in manufacturing). The agreement transfers a non-exclusive limited license to Company B and as a result Company A gets to use the forklift exempt from tax, with scheduling priority.

The AHC found that APLUX was "in the business" of purchasing and owning aircraft—specifically the TBM and the Excel. (L.F. 00045-00046). However, the AHC did not address the Director's argument that APLUX did not qualify for a sale for resale exemption under § 144.615(6). (L.F. 00056). The AHC found that this Court "analyzed the claimed resale tax exemption for the aircraft leased by Business Aviation based upon 'the interplay of sections 144.018.1(4), 144.615(3), and 144.030.2(20).'" (L.F. 00056) (quoting *Business Aviation*, 579 S.W.3d at 219). The AHC stated that it was unnecessary for it to address the Director's arguments that APLUX did not meet the qualifications for the exemption from use tax under § 144.615(6). (L.F. 00056). Because the AHC did not make a finding on this issue, there is no finding before this Court that APLUX met the requirements for this particular statutory exemption.

The AHC erred in holding that APLUX was entitled to a use tax exemption on two purchased aircraft because the purchase did not qualify for the resale exception under § 144.018.1(4). In order to qualify for this exception, the subsequent sale must have been "subject to tax but exempt under this chapter" meaning that the sale of the Aircraft from APLUX to Luxco must qualify for an exemption under Chapter 144. In *Business Aviation*, this Court found that the interplay of § 144.018.1(4) and sections 144.615(3) and 144.030.2(20), exempted the purchased Airplane from sales tax because the Airplane was leased to a common carrier. 579 S.W.3d at 216-219. As discussed

above, APLUX's lease with Luxco did not qualify for an exemption under sections 144.615(3) or 144.030.2(20) because Luxco was not a common carrier. APLUX's lease of the Excel to Aero should not qualify for a sale for resale exemption because the lease was not similar to the lease in *Business Aviation*, which was "exclusive," "complete," and the equivalent of an outright sale. *Business Aviation*, 579 S.W.3d at 217-219; *See generally Five Delta Alpha*, 458 S.W.3d at 822.

Section 144.018 does not offer an entirely new resale exemption or exclusion as described in subsection 4. Its stated purpose was to overrule an additional judicial limitation placed on the claiming of the statutory resale exemption.[10] Giving effect to § 144.018.1 as a separate resale exclusion renders sections 144.615(6) and 144.010.1(11) superfluous. "This Court assumes that the legislature does not intend to perform a useless act." *E & B Granite, Inc. v. Dir. of Revenue*, 331 S.W.3d 314, 317 (Mo. banc 2011). Nor, as demonstrated by the present case, does it serve the underlying rationale behind the sale for resale exemption. The stated purpose of the exemption is to avoid multiple

[10] In *ICC Management*, this Court held that a resale exemption cannot be claimed if the subsequent sale was exempted or excluded from tax. 209 S.W.3d at 703. This was an extension of the Court's previous holding in *Westwood Country Club v. Director of Revenue*, 6 S.W.3d 885, 889 (Mo. banc 1999), that an item must be taxed only once. Therefore, § 144.018 has no *direct* application to the present case because APLUX did not resell the aircraft, without regard to whether the subsequent sale was exempt from tax.

taxation of the same item as it passes through the chain of commerce, thus avoiding an increased cost to jobbers, wholesalers, manufacturers, and retailers while still guaranteeing that the state receives use tax from the end consumer once the item finally comes to rest within the state.

The only exemption that could be correctly applied to the lease between APLUX and Luxco is § 144.615(6) which requires that the taxable property at issue be "held by processors, retailers, importers, manufacturers, wholesalers, or jobbers solely for resale in the regular course of business." APLUX was none of these things and the AHC specifically declined to find that APLUX met the requirements of this exemption.

APLUX's purchase of the Aircraft is subject to consumer's use tax because APLUX maintained taxable use over the Aircraft in that it maintained operational control, priority of use, and executed non-exclusive leases with its parent company, Luxco, and with Aero, a common-carrier. APLUX was the ultimate end consumer for the aircraft and thus liable for the use tax for its purchase. Affirming the AHC's decision does not serve the purpose of avoiding multiple taxation as the Aircraft passes through the chain of commerce. Here, there is no chain—only the appearance of one.

II. The administrative hearing commission erred in holding that APLUX was entitled to a use tax exemption on two purchased aircraft, because the economic and substantive realities of the transactions show that the aircraft were not purchased for resale, in that many of the formalities normally expected in an aircraft leasing transaction were replaced by inter-company transactions, APLUX was not a financially viable business, and there is no evidence that the leases were actually negotiated.

The AHC erred in finding that there was a lease that qualified for a sale for resale exemption because the same person negotiated the terms of the lease as both the lessor and lessee. Because Mr. Lux had ultimate and total control over both APLUX and Luxco, the "sales" between APLUX and Luxco were simply "sales" to himself. The lack of tax-independent considerations indicates the true purpose of APLUX was merely tax avoidance. In light of the economic realities, the lease arrangement should not be recognized as a "sale". To recognize such an arrangement devoid of economic substance would go against foundational tax law principles.

A. Underlying Case Law

To qualify for the resale exemption, the underlying sale, lease, or transfer must be an actual sale, lease, or transfer. To put another way, the sale, lease, or transfer must have economic substance. The necessity of

economic substance in tax analysis has been clear since *Gregory v. Helvering*, 293 U.S. 465 (1935) and *Higgins v. Smith*, 308 U.S. 473 (1940). In *Gregory*, the taxpayer tried to claim an income tax exemption on an underlying transfer of stocks, but the Supreme Court held the transfer was not really a transfer. The taxpayer had "reorganized" part of her business into a new business, transferred stocks into the new business, subsequently liquidated the stocks, and finally did not report the capital gains, citing a "reorganization" exemption. *Id.* at 467-468. Although the taxpayer had indeed met all technical requirements found in the tax code, the Court sided with the Commissioner in disallowing the exemption. *Id.* at 469-470. Since the taxpayer's new corporation was "[s]imply an operation having no business or corporate purpose" (except evading taxes), the Court held that the "[new] corporation was nothing more than a contrivance." *Id*. at 469. Thus, there was no actual underlying transfer on which the taxpayer could claim the exemption. *Id.* In *Gregory*, the Court established that the law would not "exalt artifice above reality." *Id*. at 470.

The Court held to this rule in *Higgins*. In disallowing the taxpayer's claimed deduction on a loss from a sale to his own wholly-owned corporation, the Court found that "the existence of an actual corporation is only one incident necessary to complete an actual sale to it." *Higgins*, 308 U.S. at 476. Dispositive was the fact that the taxpayer owned all of the stock in the company to which

he made the transfer. *Id.* at 476-480. Since the taxpayer had control on both ends of the transaction, there was not a transfer in any real sense and the taxpayer was not entitled to claim a deduction from the "loss." *Id.* The "transfers" were "simply [from taxpayer's] left hand… into his right hand, so that in truth and fact there was no transfer at all." *Id.* at 475.

Missouri has followed suit in recognizing the necessity of economic substance. In "determining the merits of revenue cases, it is important to look beyond legal fictions to discover the economic realities of the case." *Loren Cook*, 414 S.W.3d at 454 (quoting *Great Southern Bank v. Dir. of Revenue*, 269 S.W.3d 22, 25 (Mo. banc 2008)).

The requirement of economic substance in no way conflicts with the ordinary rule of observing legal forms. Ordinarily the law will treat two commonly owned corporations as separate if they are separately incorporated, but such observance of legal form is done with an assumption of underlying economic substance. "[O]rdinarily two separate corporations are to be regarded as wholly distinct legal entities, even though the stock of the one is owned partly or entirely by the other...[i]f the purpose served by the arrangement is fair and lawful, then legal forms and relationships are to be observed[.]" *Central Cooling & Supply Co. v. Dir. of Revenue*, 648 S.W.2d 546, 548 (Mo. banc 1982); *see also Moline Properties v. CIR*, 319 U.S. 436, 439 (1943) (where the Court treated two commonly owned corporations as separate for purposes

of imposing tax, but distinguished the case from "matters relating to revenue, [where] the corporate form may be disregarded where it is a sham or unreal."). In other words, economic substance is assumed when observing legal forms. *See May Department Stores Co. v. Union Electric Light & Power Co.*, 107 S.W.2d 41, 55 (Mo. 1937); *Phelps v. Missouri-Kansas-Texas R. Co.*, 438 S.W.2d 181, 186 (Mo. 1968).

More specifically, observing legal forms absent economic substance is not appropriate for tax exemption analysis. In *Higgins,* the Supreme Court observed legal forms when imposing tax but did not acquiesce to taxpayer's manipulation of legal forms to escape tax, stating: "A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages. On the other hand**,** the Government may not be required to acquiesce in the taxpayer's election… the Government may look at actualities and upon determination that the form… is unreal or a sham…may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute." *Higgins*, 308 U.S. at 477; *see also Central Cooling*, 648 S.W.2d at 548; *Moline* 319 U.S. at 439; *Burnet v. Commonwealth Improvement Co.*, 287 U.S. 415, 419 (1932).

B. Application

APLUX and Luxco were both incorporated, but separate incorporation in itself is not sufficient to qualify the APLUX-Luxco leases as having economic

substance. *Higgins*, 308 U.S. at 476. Despite legal artifice, the facts belie the reality of the APLUX-Luxco leases. Since Mr. Lux had complete control of both corporations, the "leases" from Mr. Lux to himself were not true resales.

APLUX and Luxco were completely controlled by the same person. Mr. Lux was the CEO and chairman of the board of Luxco, owning 100% of Luxco's voting stock. (L.F. 00044). Mr. Lux created and managed APLUX as well. (L.F. 00044). APLUX was a wholly-owned subsidiary of Luxco with Luxco as its only member after 2011. (L.F. 00044). "[D]omination and control is…obvious in a wholly owned corporation." *Higgins*, 308 U.S. at 476. Thus, there was no "genuine multiple-party transaction with economic substance." *Frank Lyon Co. v. U.S.,* 435 U.S. 561, 583 (1978).

A lack of economic substance is evidenced by how Mr. Lux "negotiated" the APLUX-Luxco leases with himself. With the help of his lawyers and accountants, Mr. Lux set arbitrary, flat rates on the two leases. (L.F. 00050). Compare the APLUX-Luxco leases' terms with the Aero-APLUX lease terms. For the Excel-Aero lease, APLUX received $1,450 per flight hour, in line with Federal Aviation Regulations. (L.F. 00048). In comparison, the TBM-Luxco lease was set at a flat $114,000 annually (L.F. 00046) and the Excel-Luxco lease was set at only $117,600 annually (L.F. 00048). The rates were not enough for APLUX to even be profitable on the Luxco leases. (L.F. 00062-00063). Mr. Lux's indifference to profit on the Luxco leases is but further

evidence that the creation of APLUX was not for legitimate business but for tax avoidance.[11] It should come as no surprise that Mr. Lux's rates on the leases to himself were set so low, as this was indeed the point. By setting the lease rates low, Mr. Lux could pay minimal lease tax in lieu of purchase tax, after he had falsely claimed the option to do so in the first place.

Additionally, the nature of the transactions shows a lack of economic substance. The money APLUX used to purchase the Aircraft came from Luxco. (L.F. 00046). And Mr. Lux was the one to execute the contract for both APLUX and Luxco. (L.F. 00045). Furthermore, Luxco did not actually remit payments to APLUX on the lease; instead, Luxco made intercompany transfers to APLUX (whose income passes through to its shareholders which are the shareholders of Luxco) and then zeroed out the amounts "paid" in its general ledger. (L.F. 00047).

By controlling both APLUX and Luxco, Mr. Lux had total control over both sides to the "transfers," he was completely in charge of setting the "terms," and he shook hands with himself at the end. He passed money from his left pocket to his right pocket, and back again. All taken together, the facts

[11] The AHC discounted this fact by noting that consideration does not require profit. (L.F. 00063). However, the AHC's reasoning misses the point. Consideration is the third requirement for the resale exemption. *See Business Aviation*, 579 S.W.3d at 217. But indifference to profit is relevant as speaking to the first requirement (a transfer with economic substance), not to the third requirement (consideration).

surrounding the APLUX-Luxco leases are "susceptible of but one interpretation" (*Gregory*, 293 U.S. at 470): there were "no transfer[s] at all." *Higgins*, 308 U.S. at 475.

Allowing a transaction without economic substance is anathema to the intent behind the resale exemption. The intent of the resale exemption is to prevent double taxation and to impose the sales or use tax on the final end user. *See President Casino*, 219 S.W.3d at 238; *Sipco*, 875 S.W.2d at 541. However, in this case the use tax in large part was not passed to the end user—it simply disappeared. This is because the end user and the purchaser were the same person—Mr. Lux. Since Mr. Lux was able to set his own lease price on the lease to himself, he was able to avoid substantial tax altogether by paying much less in lease tax than he would have had to pay on the use tax at purchase. Such an incredible arrangement is clearly "outside the plain intent" of the resale exemption statute. *Gregory*, 293 U.S. at 470. It defies common sense to suggest the legislature intended a taxpayer be given a resale exemption for a resale to himself at a lower price he himself decided.

APLUX argues that legal forms should be observed because APLUX was created with a "proper purpose."[12] APLUX's argument subtly assumes the

[12] The proper purpose test asks whether the arrangement between two corporations is being employed for a proper business purpose. If separate incorporation has bestowed a business advantage, then the two commonly-owned corporations must be treated as such in order to bear any applicable tax

"proper purpose" test absent economic substance as sufficient for observing legal forms. In its brief to the AHC, APLUX cited *Central Cooling* which, referencing a California case, states that "[i]n tax matters a corporation and its stockholders are deemed separate entities." *Central Cooling*, 648 S.W.2d at 548 (referencing *Rexall Drug Co. v. Peterson*, 113 Cal.App.2d 528 (1952)). Yet *Rexall* also says that despite the ordinary observance of legal forms, "to prevent fraud or injustice, the law will look through what has been termed the corporate veil[.]" *Rexall*, 113 Cal.App.2d at 530. In other words, the proper purpose test absent economic substance is not sufficient for observing legal forms in order to allow an exemption.

The proper purpose test is only sufficient to *impose* a requirement. In *Central Cooling*, Johnson Furnace Co. created wholly-owned subsidiary Central Cooling & Supply Co. for the proper business purpose of "gaining a business advantage by obtaining supplies at wholesale prices." *Central Cooling*, 648 S.W.2d at 548. The Missouri Supreme Court held that Central Cooling must therefore also pay sales and use tax on transfers to Johnson (in other words, Central Cooling and Johnson must be treated as separate for tax purposes, despite common ownership). This would prevent Central from gaining an "unfair [business] advantage." *Id.* at 549. In *Moline*, pressure from

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burdens. *See Central Cooling,* 648 S.W.2d at 548-549; *Moline*, 319 U.S. at 439-440.

creditors made advantageous the taxpayer's creation of a separate corporation. *Moline*, 319 U.S. at 440. Therefore, the taxpayer also had to bear a separate tax burden (in other words, the legal forms must be observed despite common ownership). *Id.* at 439-440. In neither *Central Cooling* nor *Moline* were legal forms observed for tax evasion, but rather for imposing tax. These cases both follow the Supreme Court's holding in *Higgins*:

> A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages. On the other hand**,** the Government may not be required to acquiesce in the taxpayer's election… the Government may look at actualities and upon determination that the form… is unreal or a sham…may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute.

Higgins, 308 U.S. at 477.

Because the APLUX-Luxco leases lacked economic substance, the purpose of the APLUX-Luxco arrangement is insufficient grounds for allowing the resale exemption. Even if purpose needed to be considered, the proper purpose test would further prove the State's case. As APLUX's expenses far exceeded its income, and as the "business" did no business outside the Aircraft, Mr. Lux can point to no "tax-independent considerations" behind APLUX's existence. *See Frank Lyon*, 435 U.S. at 583. Central Cooling was formed so Johnson could get supplies at wholesale prices, and Moline Properties was formed as a response to the taxpayer's creditors. *See Central Cooling*, 648

S.W.2d at 548; *Moline*, 319 U.S. at 440. In contrast, the auditor here concluded, "APLUX was not really a business, [it was] just two airplanes." (Tr. 22). APLUX was a "mere device" for the achievement of a "preconceived plan." *Gregory*, 293 U.S. at 469-470*; see also Higgins*, 308 U.S. at 476-477, *Central Cooling*, 648 S.W.2d at 548 (majority) and 549 (dissent), *Moline*, 319 U.S. at 439.

Mr. Lux was free to form APLUX if he felt it would give him some business advantage. But the question of claiming a tax exemption falls under a different analysis. In *Loren Cook*, the Missouri Supreme Court disregarded a document transferring an aircraft's title from one party to another because the reality of the transaction was that the one party was only serving as the agent of the other. 414 S.W.3d at 454. The situation here is comparable. Given that Mr. Lux had complete control over both ends of the APLUX-Luxco "leases," the fact that APLUX and Luxco were separately incorporated does not mean that APLUX and Luxco should be viewed as separate corporations as it pertains to this "transfer." As the "sales" from APLUX to Luxco were thus not actually sales, the AHC erred in ruling APLUX qualified for the resale exemption.

C. Conclusion

APLUX's purchase of the Aircraft is subject to consumer use tax because APLUX maintained taxable use over the Aircraft in that it maintained

operational control, priority of use, and executed non-exclusive leases with its parent company, Luxco, and with Aero, a common-carrier. APLUX was the ultimate end consumer for the aircraft and thus liable for the use tax for its purchase. Affirming the AHC's decision does not serve the purpose of avoiding multiple taxation as the Aircraft passes through the chain of commerce. Here, there is no chain—only the appearance of one.

CONCLUSION

For the foregoing reasons, the Director of Revenue respectfully requests that this Court reverse the judgment of the Administrative Hearing Commission.[13]

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The attached brief complies with the limitations contained in Missouri Supreme Court Rule 84.06 and contains 12,246 words, excluding the cover, certification and appendix, as determined by Microsoft Word 2016 software; and that pursuant to Rule 103.08, the brief was served upon all other parties through the electronic filing system.

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