DOTHAN JET CENTER, INC. Route 6 Box 205 Dothan, Alabama 36303,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 95-172
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed State, Houston County, and City of Dothan sales and use tax against Dothan Jet Center, Inc. ("Taxpayer") for the period January 1992 through December 1993. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on June 12, 1995. CPA Thomas Parish, Jr. represented the Taxpayer. Assistant Counsel Claude Patton represented the Department.

This case involves two disputed issues:

(1) The Taxpayer purchased airplanes at wholesale for resale during the subject period. Some of the airplanes were subsequently set aside and used by the Taxpayer in a pilot training program. The primary issue is whether those airplanes withdrawn from inventory and used by the Taxpayer for pilot training should be taxed under the sales tax "withdrawal" provision, Code of Ala. 1975, §40-23-1(a)(10);

(2) A second and related issue is whether repair parts withdrawn from inventory and used to repair the training program airplanes should also be taxed under the "withdrawal" provision.

The Department also assessed tax on supply items used by the Taxpayer, and on charges for sub-let repairs. Those adjustments are not disputed by the Taxpayer.

The Taxpayer repairs airplanes and also purchases new and used airplanes tax-free for resale. The Taxpayer maintained an average inventory of approximately 15 to 25 airplanes during the audit period.

The Taxpayer also operates a pilot training business. Some of the airplanes purchased tax-free are used by the Taxpayer in the training program.

The Taxpayer, upon audit, provided a Department examiner with a list of ten airplanes that had been specifically set aside for use in the pilot training program. The Department subsequently assessed sales tax on the wholesale cost of those airplanes under the "withdrawal" provision found at §40-23-1(a)(10). Other airplanes that were only occasionally used for pilot training were not taxed.

The "withdrawal" provision defines "retail sale" to include the "withdrawal, use or consumption of any tangible personal property by anyone who purchases same at wholesale, . . .". The "withdrawal" provision was intended to tax property purchased tax-free for resale that is instead used or consumed by the wholesale purchaser. Alabama Precast Products, Inc. v. Boswell, 357 So.2d 985 (Ala.Civ.App. 1978).

Four Alabama cases involving the "withdrawal" provision are relevant in this case. State v. Kershaw Manufacturing Co., 137 So.2d 740 (1962); Montgomery Aviation Corp. v. State, 154 So.2d 24 (1963), Drennen Motor Co. v. State, 185 So.2d 405 (1966); and State v. Barnes, 233 So.2d 83 (Ala.Civ.App. 1970).

In Kershaw, the taxpayer manufactured railroad equipment that was subsequently leased by the taxpayer. The parts used to manufacture the equipment had been purchased tax-free. The Supreme Court held that the leasing of the equipment for profit was a taxable withdrawal.

> The taxpayer has, instead of selling the manufactured product, leased the same for profit. It is true that the taxpayer is in the business of manufacturing these machines for sale. But, more accurately, we think, he is in the business of manufacturing machines for profit. If the profit is a result of sale, he is under an obligation to collect sales tax, assuming the sale is not otherwise exempt from tax. It is the transaction itself which is taxable. If, on the other hand, instead of selling the machines for profit, the appellee leases them, then it is our view that the transaction amounts to a 'withdrawal' for the use and benefit of the taxpayer, and as such the transaction is taxable. It is just this kind of transaction, as we see it, which §752, Title 51, sub. (j) (now §40-23-1(a)(10)) was enacted to reach.

Kershaw, at page 742.

Montgomery Aviation was decided in 1963, a year after Kershaw. In Montgomery Aviation, the taxpayer purchased airplanes tax-free for resale. Customers were allowed to fly an airplane that they intended to buy and were "customarily charged for a demonstration of the plane in which he is interested". Montgomery Aviation, at

page 26. The planes were not otherwise rented except as demonstrators. The planes were held in inventory on average two or three months, and were rented on average eleven to fifteen hours during that period. All of the planes were subsequently sold at retail for the same sales price as a new plane.

The Supreme Court distinguished Montgomery Aviation from Kershaw, and held that the rental of the airplanes as demonstrators did not constitute a taxable withdrawal. Here the planes were not leased, as in the Kershaw case.

> It is not contended nor do we find any evidence to show, that any planes were 'consumed' by rental service.

Montgomery Aviation, at page 26.

On rehearing, the Supreme Court again distinguished the Kershaw case on its facts.

> In distinguishing the Kershaw case, 273 Ala. 215, 137 So.2d 740 from the case at bar we observed that some of the machines in Kershaw were *consumed* in use or 'junked', and that in this case there was no question of consumption through use. Moreover, here we pointed out that appellee's theory was that any withdrawal, however short the time, gave rise to the sales tax. In this case we were dealing with the case presented upon its own peculiar facts. The evidence presented by appellant revealed an unusual course of dealing in its business-using newly purchased planes in rental service and subsequently selling the planes at the original sale price.

Montgomery Aviation, at page 27.

In summary, the "withdrawal" provision applied in Kershaw because the Supreme Court determined that the railroad equipment had been "consumed" by the leases, whereas the rental of the

airplanes as demonstrators in Montgomery Aviation did not reach the level of a taxable consumption.[1]

In Drennen Motor, decided in 1966, a car dealership used certain new cars as demonstrators. The demonstrators were subsequently sold on average for 4.5% less than a non-demonstrator. The vehicles were used as demonstrators for as little as one-half a day up to 300 days before being sold. The Department determined that use of a vehicle as a demonstrator for more than two weeks constituted "substantial use", and thus taxed those vehicles under the "withdrawal" provision. The Supreme Court rejected the Department's position as follows:

> We are persuaded that the designation and use of the automobiles as demonstrators, as shown by the testimony in this case, was not such a withdrawal and use as makes the withdrawal or the use, or both together, a taxable event.
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> * * *

[1]The Court held that all of the railroad equipment in Kershaw was "consumed" and thus taxable under the "withdrawal" provision, even though some of the equipment was apparently later sold at retail.

> We are not persuaded that the language of the statute expresses an intention to tax, prior to the sale, the use of a piece of merchandise as a demonstrator when the merchandise remains in stock, is available at all times for sale, is used only to promote selling, and is, in every case without exception, sold, and the average selling price is approximately four and one-half per cent less than the average selling price of new merchandise which has not been used as a demonstrator.

Drennen Motor, at page 411.

Finally, in Barnes, decided in 1970, the Court of Civil Appeals held that phonograph records purchased tax-free for resale but subsequently withdrawn from inventory and used in jukeboxes owned by the taxpayer were taxable under the "withdrawal" provision, even though the used records were later returned to inventory and sold at retail. The Court, citing Starlite Lanes, Inc. v. State, 214 So.2d 324 (1968), held that impermissible double taxation did not occur because the same party was not taxed twice. The tax due on the withdrawal was levied against the taxpayer, whereas the tax due on the subsequent retail sale of the used records was on the taxpayer's customers. The Court also held that the retail price for which an item is subsequently sold has no bearing on the applicability of the "withdrawal" provision.

The above cases were decided on the particular facts of each case. But the general rule established is that property purchased at wholesale and subsequently used by the wholesale purchaser is taxable under the "withdrawal" provision if the use by the wholesale purchaser is substantial and constitutes in effect a

consumption of the property. The above is true even if the property is subsequently sold at retail.

In Kershaw and Barnes, the lease of the railroad equipment and the use of the records, respectively, constituted a taxable withdrawal because the items were substantially used or "consumed" by the taxpayer in a profit-seeking business activity separate and apart from the sale of the property. The "withdrawal" provision applied in both cases even though some of the railroad equipment in Kershaw and all of the used records in Barnes were subsequently sold at retail.

On the other hand, the airplanes in Montgomery Aviation and the motor vehicles in Drennen Motor were used only as demonstrators for the purpose of promoting their sale. Their use as demonstrators was limited, not substantial, and they were not used in a profit-seeking activity unrelated to the intended sale of the item.

Turning to this case, the airplanes in issue were specifically set aside for use in the pilot training program. The airplanes were also used substantially longer than the average two to three months that the airplanes were held in Montgomery Aviation. Only one of the ten planes has been sold, and it was held for 17 months (September 1992 - February 1994) before being sold. The remaining nine planes were all purchased from November 1992 through September 1993, and none have been sold as of June 1995, an average period of

over two years.

Being used as training planes for over two years, a reasonable inference also is that the planes have all been flown considerably more than the average 11 to 15 hours that the planes in Montgomery Aviation were used. The fact that a great majority of the Taxpayer's repairs were performed on the training planes also indicates extensive usage.

Based on the specific facts of this case, the substantial, extended use of the airplanes by the Taxpayer in its pilot training program constituted a taxable use under §40-23-1(a)(10). Otherwise, the Taxpayer would be allowed to purchase airplanes tax-free, presumably for resale, but instead use the airplanes for profit for a period of years without paying sales tax. The Taxpayer claims that the airplanes are being held for sale. However, in substance the subject airplanes were and are being used for profit. The fact that the airplanes may be sold at some point does not change the above result. Nor, according to Barnes, is it relevant what the airplanes might be sold for.

The above considered, the airplanes in issue and the repair parts withdrawn and used to repair those airplanes were properly taxed by the Department. The assessments in issue are accordingly affirmed. Judgment is entered against the Taxpayer for State sales tax in the amount of $14,994.41, State use tax in the amount of $1,038.20, Dale County sales and use tax in the amount of $4,292.65, and City of Dothan sales and use tax in the amount of $10,017.35, plus applicable interest.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered September 20, 1995.

BILL THOMPSON
Chief Administrative Law Judge