

OHIO BOARD OF TAX APPEALS

Castle Aviation, Inc.,)
)
 Appellant,) (USE TAX)
)
 vs.) DECISION AND ORDER
)
 Thomas Zaino,)
 Tax Commissioner of Ohio,) **Affirmed on Appeal May 31, 2006**
) **Ohio Supreme Court**
 Appellee.)

APPEARANCES: 109 Ohio St.3d 290, 2006-Ohio-2420

For the Appellant - Buckingham, Doolittle & Burroughs, LLP
Steven A. Dimengo
David W. Hilkert
50 S. Main Street,
P.O. Box 1500
Akron, Ohio 44309

For the Appellee - Jim Petro
Attorney General of Ohio
Barton Hubbard
Assistant Attorney General
State Office Tower
30 East Broad Street, 16th Floor
Columbus, Ohio 43266-0410

Entered January 14, 2005

Ms. Jackson, Ms. Margulies, and Mr. Eberhart concur.

This cause and matter comes to be considered by the Board of Tax Appeals upon a notice of appeal filed on January 27, 2003. Appellant, Castle Aviation, Inc. (“Castle”), challenges a final determination of the Tax Commissioner, appellee herein, dated November 27, 2002, wherein the Tax Commissioner conditionally remitted the penalties charged against an assessment

issued as a result of a use tax audit of Castle's purchases. Except for the conditional remission of penalties, the assessment was affirmed. The assessment covers the period January 1, 1996 through December 31, 1999. The final determination is incorporated as if fully rewritten herein.

Castle is an Ohio corporation and during the audit period operated an air transportation service. Castle had some long-term contracts requiring it to provide shipping services on a regular basis and also operated an on-demand passenger and cargo transportation service. A purchase audit was conducted, and it was determined that Castle failed to fully remit use taxes owed the state of Ohio. A petition for reassessment was filed and the Tax Commissioner affirmed in principle his assessment (subject to the conditional waiver of penalties noted above). An appeal to this board followed.

The errors claimed by Castle in its Notice of Appeal are as follows:

"1. Castle was erroneously assessed tax on the following purchases: Leases of airplanes, airplane fuel, aeronautical maps, airplane supplies, airplane oil, airplane parts and repairs/installation and aeronautical publications which are exempt from tax pursuant to R.C. 5739.01(E)(2) (exemption for property used directly in rendering a public utility service), R.C. 5739.02(B)(33) (exemption for property primarily used in highway transportation for hire), R.C. 5739.02(B)(14) (exemption for ships and vessels used principally in interstate commerce), and R.C. 5739.01(B)(3)(a)(b) (exemption for repairs/installation of exempt property).

"2. The imposition of use tax on Castle's purchases described in paragraph 1 violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and Article I, §2 of the Ohio Constitution.

“3. The Tax Commissioner overstated the level of Castle’s taxable purchases.

“4. The Tax Commissioner imposes tax on costs associated with the property described in paragraph 1 which is not subject to tax pursuant to R.C. 5739.01(B) and 5739.02(B).

“5. The determination of the Tax Commissioner is not based on evidence and is contrary to law.”

The matter is considered by the Board of Tax Appeals upon the notice of appeal, the statutory transcript certified to this board by the Tax Commissioner, and the record of the merit hearing, as well as the exhibits introduced at that time. The board also has received legal argument from counsel representing Castle and the Tax Commissioner.

We begin our consideration of this matter by acknowledging the duties imposed upon the Board of Tax Appeals when reviewing a decision of the Tax Commissioner. The Tax Commissioner’s findings are entitled to a presumption of correctness and it is incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121; *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St. 2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner’s determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

As to the general law relating to the excise tax imposed upon sales of tangible personal property, such sales (and the purchase of some services) are taxable unless an exception or exemption to the collection of sales tax has been provided by the legislature. R.C. 5739.01 and R.C. 5739.02. As a result of the basic presumption that all sales of tangible personal property made within the state are subject to tax, the courts have determined that exceptions and exemptions from taxation are to be strictly construed in favor of taxation. *Ball Corp. v. Limbach* (1992), 62 Ohio St.3d 474; *Highlights for Children, Inc. v. Collins* (1977), 50 Ohio St.2d 186. Also pertinent to this appeal is the corresponding nature of the sales and use taxes. By virtue of R.C. 5741.02(C)(2), exemptions from sales taxation also apply to Ohio use taxation. Thus, our discussion encompasses the sales tax statutes.

In order to fully consider the taxable status of the purchases made by Castle, it is critical to review Castle's business operations and place that business in a historical context. As to Castle's business operations, Mr. Michael H. Grossman, Castle's president and one hundred percent owner, testified before this board. He testified generally about Castle and told of how he originally started in the aviation transportation business. Mr. Grossman testified that Castle grew out of a love of flying and the belief he could successfully run an air transportation service.

Mr. Grossman explained that Castle is a charter operation. According to Mr. Grossman, there are over 3,000 charter operators in the United

States. Castle's activity is primarily cargo, but it does have available planes to transport passengers. However, Mr. Grossman explained, whether cargo or passenger, all transportation services offered by Castle are classified as charter.

During the audit period, Castle owned or leased eight planes, ranging in size from twin-engine pistons to single-engine, turbine-powered aircraft. Castle regularly serviced two customers on a daily or weekly basis. One contract was with the New York Times to deliver its newspapers printed in the Canton area to both Toronto, Ontario and Louisville, Kentucky for home delivery, and the second was with Purolator Canada, a delivery service, to regularly transport certain tools from Ohio to a Purolator location in Canada for further delivery.

While Castle's long-term contracts were few, it also had a significant base of customers who sought flight services on an as-needed basis. The customers might have originally found Castle through its advertisements in a publication known as the "Air Charter Guide," which offers charter flights to individuals and businesses, or through the telephone directory. These customers may use Castle's services only once, or they may be a source of repeat business, but this group of customers did not enter into long-term contracts for transportation services. Instead, these customers contracted individually for each flight.

The company also accepted assignments through freight brokers. The freight brokerage business has grown from a need recognized by the charter flight industry. Because of changes in the manner other businesses operate, such

as the manufacturing industry's move to "just-in-time" inventory systems, a need has arisen for immediate delivery services when turn-around times are not sufficient to allow for more traditional (i.e., truck hauling) transportation services. Because the need for goods or persons is immediate, a customer may wish to contact a broker who has at its disposal many potential charter flight service providers rather than attempting to make contact with the limited number of charter service providers the customer may know. Through the use of a broker, the customer may save itself time and money in comparison to directly contacting a charter flight service.

Interested charter flight services bid on individual jobs that may fit into their pre-planned runs. The Internet also has expanded this end of the business. Websites now exist where a charter flight service can find potential jobs. The broker system usually results in the service provider charging a lower-than-advertised rate so that the broker's fee will be built into any final charge to the customer. Mr. Grossman likened the difference between rates charged to brokers and rates charged to the customers to the difference between wholesale and retail sales.

Not only brokers received rates discounted from the published rates. Mr. Grossman also explained that repeat customers could also receive discounts. Similarly, long-term contracts, such as those with the New York Times and Purolator, are generally negotiated at less than the published rates.

Mr. Grossman testified that Castle's services were available 365 days a year and its customer base included anyone who would contact Castle for flight services. Mr. Grossman also testified that even if his planes were all flying, he was able to accept jobs and either lease additional planes or broker the job to another charter service.

Describing the industry itself at hearing was Michael P. Fleming of PA Consulting Group. PA Consulting Group is a management consulting firm. Mr. Fleming works in its "Transportation Group" and primarily focuses on the aviation industry. Mr. Fleming described licensing requirements placed upon air charter businesses such as Castle.

Mr. Fleming distinguished between Federal Department of Transportation ("DOT") regulations, which encompassed economic regulations,¹ and Federal Aviation Administration ("FAA") regulations, which encompassed safety regulations. There are a number of classifications used by the DOT and the FAA. Mr. Fleming made the point that many of the DOT regulations, as well as the Civil Aeronautics Board ("CAB")² regulations, were created during the era of regulatory control when there was less of a free-market dynamic in play. At that time the federal government granted entry into and exit from a particular service area through the issuance of a "Certificate of Public Convenience and Necessity."

¹ Mr. Fleming testified that much of the economic regulation has been eliminated since airline deregulation took place, but there still exists what is called "the fitness test" of Section 41102 of Title 49 USC. Certain exemptions to the fitness test are found in Section 298. One such exemption is what the DOT calls "air taxi operations."

² The CAB was an independent agency abolished by the Airline Deregulation Act. Its functions were transferred to the DOT.

While there were some exceptions to such a certificate prior to deregulation, all common carriers were required to have such a certificate, and air charter operations similar to Castle were exempt under Part 298 of the federal aviation regulations.

After federal deregulation of the airline industry, Mr. Fleming testified, a carrier is first classified as engaged in private operations or in commercial operations. The distinction relates to the collection of certain federal excise taxes. Mr. Fleming explained that certain federal excise taxes are required to be collected and remitted by commercial operators, but the same requirements are not imposed upon private operators. It was Mr. Fleming's opinion that Castle would qualify as a commercial operation.

The next global classification for FAA purposes is common carriage. According to the witness, FAA regulations require common carriers to make their services available to the general public. It was Mr. Fleming's opinion that Castle, by advertising in the Air Charter Guide, held its services out to the general public. Castle also holds an Air Carrier Certificate which indicates that Castle operates as a common carrier.

Mr. Fleming explained that FAA licensing requirements could take various forms, but are essentially applicable to either a carrier regulated under Part 121 of the federal regulations or a carrier regulated under Part 135 of the same regulations. Mr. Fleming also testified as to the blending of the types of aircraft governed by the two parts of the federal aviation regulations.

Part 121 carriers are subjected to more requirements than those aircraft regulated under Part 135. Many of the additional regulations concern issues arising from the operation of larger aircraft, for originally the size of the aircraft controlled the classification. Thus, Part 121 carriers were subjected to, among other things, more stringent maintenance, hours of service, and crew regulations.

Mr. Fleming also discussed the distinction between “scheduled” and “non-scheduled” operations, informing the board that large cargo operators may engage in some scheduled operations, or may not. However, the ability to negotiate fares is not unique to only non-scheduled operations. Mr. Fleming testified that since the airline deregulation, regulations concerning fares have been liberalized and now all regulated airlines may negotiate fares.

Mr. Fleming was asked specifically about the essentiality of the services provided by Castle and other Part 135 carriers. Mr. Fleming responded that Part 135 carriers carried what he believed to be business critical, and in the case of the transportation of human organs, life critical supplies. Mr. Fleming also noted that there are approximately 7,000 aircraft flying under Part 135 regulations. Given the number of aircraft flying and the nature of the cargo, it was Mr. Fleming’s opinion that the services were essential to the country’s overall transportation system.

Castle argues that the above-cited facts support a finding that with respect to purchases used in the rendition of its charter transportation services, it

qualifies for an exception from the excise tax imposed upon retail sales by R.C.

5739.02, which provides in part:

“For the purpose of providing revenue with which to meet the needs of the state, for the use of the general revenue fund of the state, for the purpose of securing a thorough and efficient system of common schools throughout the state, for the purpose of affording revenues, in addition to those from general property taxes, permitted under constitutional limitations, and from other sources, for the support of local governmental functions, and for the purpose of reimbursing the state for the expense of administering this chapter, an excise tax is hereby levied on each retail sale made in this state.”

One exception from taxation claimed by Castle to apply to its purchases is found in R.C. 5739.01(E)(2) (as it existed during the audit period).

That section provided:

“‘Retail sale’ and ‘sales at retail’ include all sales except those in which the purpose of the consumer is:

“ ***

“(2) ***[T]o use or consume the thing transferred *** directly in the rendition of a public utility service.”

R.C. 5739.01(P) defines the language “used directly in the rendition of a public utility service” as follows:

“*** that property which is to be incorporated into and will become a part of the consumer’s production, transmission, transportation, or distribution system and which retains its classification as tangible personal property after such incorporation; fuel or power used in the production, transmission, transportation, or distribution system; and tangible personal property used in the repair and maintenance of the production, transmission, transportation or distribution system,

including only such motor vehicles as are specially designed and equipped for such use. Tangible personal property and services used primarily in providing highway transportation for hire are not used in providing a public utility service as defined in this division.”

A consumer does not have to be defined by statute as a public utility or regulated by the state as a public utility in order to have its purchases excepted from sales and use taxes under R.C. 5739.01(E)(2) and R.C. 5741.02(C)(2). *Trans World Airlines, Inc. v. Porterfield* (1970), 22 Ohio St.2d 177; *Warner Cable Communications, Inc. v. Limbach*, 67 Ohio App. 3d 458. To constitute a “public utility,” the devotion to public use must be of such character that the product and service are available to the public generally and indiscriminately, or there must be the acceptance by the utility of public franchises or calling to its aid the police power of the state. *Id.*; *Southern Ohio Power Co. v. Pub. Util. Comm.* (1924), 110 Ohio St. 246.

Castle argues that it meets the “public utility” definition found in *Warner Cable Communications, Inc.*, cited above. It argues that testimony at hearing supports a finding that its services are offered to the public generally on an indiscriminate basis, and that it is held to the same regulatory scheme as Part 121 carriers whose similar purchases have previously been found to be exempt in *Trans World Airlines, Inc.*, *supra*.

The Tax Commissioner argues otherwise. The Tax Commissioner claims that while Castle’s air charter transportation services are advertised to the general public, its contracts are not public, but are negotiated individually. The

commissioner further argues that Castle does not offer regular routes available to a general, indefinite public, but its flights are determined by the businesses which contract with it on a case-by-case basis. As such, the Tax Commissioner argues, Castle's services are similar to contract hauling services, distinguished from common carrier services in *Midwest Haulers Inc. v. Glander* (1948), 150 Ohio St. 402, *Pittsburgh & Conneaut Dock Co. v. Limbach* (1985), 18 Ohio St.3d 320, and *Inland Refuse Transfer Co. v. Limbach* (1990), 53 Ohio St.3d 10.

We must agree with the Tax Commissioner. The Tax Commissioner through his final determination provides a comprehensive description of the changes made to the airline industry after deregulation in 1978. While we agree that Castle's services now fill a gap left by larger commercial airline carriers after deregulation, and such services fill a need in the country's transportation network, we do not find Castle's services meet the definition of public utility for purposes of the tax statutes. Instead, we find the relevant case law has consistently found that similarly situated transportation services do not meet the definition of public utility for excise tax exemption.

The earliest case in which purchases by a private charter company were found not to qualify for the public utility exception to taxation is *Ohio Valley Air Ways Inc. v. Bowers* (1961), 114 Ohio App. 427. In that appeal, the Hamilton County Court of Appeals affirmed a finding by this board that a helicopter airlift service did not meet its burden to prove exception to the taxability of its purchases. More specifically, the appellate court did not find that the helicopter airlift service

was a public utility for purposes of the taxing statutes. The court found that the principal determinative characteristic of a public utility was the public's legal right to demand and receive the public utility's services. The court did not find the public had such a right to demand the appellant's services in that case.

In *Marion Air Service, Inc. v. Bowers* (Dec. 20, 1962), BTA No. 49695, unreported, affirmed (Nov. 1, 1963), Marion Cty App. No. 1145, the board first compared air transportation services with motor vehicle services, utilizing the definition of "common carrier"³ found in 80 O. Jur.2d 487. That definition has been updated and now is found in 13 O. Jur.3d 576. Much of the critical language has not been changed:

"A 'carrier' is one who undertakes to transport persons or property from place to place. As a general rule, if a carrier is to be regarded as a 'common carrier,' it must dedicate its property to public use in such a manner as to be available to the public generally and indiscriminately, and the carrier must hold itself ready to service the public impartially to the limit of its capacity; if it is employed by a definite number of persons by special contract or for a special undertaking, it is a private carrier."

After concluding that the most critical aspect of common carriage is the public's right to demand such a service, the board held:

"From the testimony and evidence presented in the record before us, it is apparent that the appellant has not shown that any member of the general public has, or had, such a legal right to require that the appellant furnish airplane transportation service to him upon request. Whether the appellant furnished such service and how much it charged

³ While Castle argues that its Air Carrier Certificate authorizes it to conduct common carriage operations, we find that "common carriage" for purposes of the exceptions to taxation has a more narrow meaning than "common carriage" for purposes of FAA regulations.

for it depended entirely upon the appellant, without reference to any legal right that a member of the general public might demand that the service be furnished upon payment of a charge set by the regulatory agency which issued the license to the appellant. The appellant could refuse, at its whim, to contract with any members of the general public and the refused person would have no recourse, in court, to compel the appellant to render the desired service.” *Marion Air Service, Inc.*, at 11.

The appeal of *Dade Leasing Inc. v. Kosydar* (Sept. 16, 1974), BTA No. C-93, unreported, presents facts most similar to those presented in the present matter. In that appeal the appellant was a non-scheduled flight operator working under licenses from both the FAA and CAB. The appellant in *Dade* advertised its services generally through leaflets and through the telephone directory. If its planes were busy when a new opportunity arose, the operator trip-leased the job.

In determining that the appellant was not a public utility for purposes of the sales and use tax statutes, the board held:

“It is the finding of the Board of Tax Appeals that this Appellant is no more rendering a public utility service than any one else who may advertise a product or service for sale or rent who is not subject to a Public Control [sic] which requires that such act or service be performed or in the event that it is not performed then allows a legal right to the person or public to enforce that right.” *Id.* at 7.

The only case issued after airline deregulation discussing the propriety of assessing sales tax upon purchases made by an airplane charter service provider is *Sundorph Aeronautical Corp. v. Lindley* (Jan. 10, 1986), BTA No. 82-D-842, unreported. That case did not consider the effect of airline deregulation on the distinction between “common” and “contract” carrier, but instead relied upon

the case law issued prior to deregulation to find that a charter service was not a public utility for purposes of the imposition of sales and use taxes upon purchases made.

In that appeal, the appellant, an on-demand charter operation, carried both passengers and freight. The board found that the appellant held itself out to the public as engaged in the business of transporting persons or property for compensation upon demand.

Nevertheless, the board found that the distinctive characteristic of a common carrier was that it undertook to carry for all people, indifferently, as opposed to private carriers, who were not obligated to carry unless the obligation was “voluntarily assumed by virtue of a special contract.” *Id.* at 12. Specifically identifying the ability of some companies to negotiate lower-than-published rates, the board found that, under its license regulations, Sundorph was not required to provide the general public with the legally enforceable right to demand and receive air transportation services.

Castle argues that the landscape now has changed and the regulations placed upon Part 121 carriers such as Federal Express are now so similar to the regulations placed upon Part 135 carriers such as itself that no distinction is warranted. However, we can find no facts which would allow us to distinguish the manner in which Castle operates from the manner of operation considered by this board and courts of appeal in this state both before and after airline deregulation. Even when the Ohio Supreme Court has considered a similar

issue, the taxability of purchases when purchased under the claim of the “highway transportation for hire” exemption found in R.C. 5739.02(E)(2) and defined by R.C. 5739.02(B)(32), the court has narrowly granted the exemption, finding not only must a motor carrier hold a permit to act as a common carrier, but the goods purchased must also be used when the motor carrier is acting as a common carrier. *Midwest Haulers*, supra.

We do not agree with the Tax Commissioner’s general statement that services such as those provided by Castle are luxury services. The record confirms that the movement of light payloads on a flexible schedule is a part of the current transportation network. However, finding that Castle’s services are not luxury does not lead, ipso facto, to a finding that the services are essential. Essentiality in the context of what is a public utility relates to the vital nature of the service. *Washington Twp. Trustees v. Davis*, 95 Ohio St.3d 274, 2002 Ohio-2123. Castle has not provided evidence that if services such as those provided by it were no longer available, transportation by air would come to a halt. To the contrary, transportation by air would continue by the larger, regulated airlines. In sum, in reliance upon the earlier case law, we find that Castle does not meet the definition of a public utility and therefore we find that its purchases are not excepted from taxation under R.C. 5739.01(E)(2).

Castle also challenges the taxability of the assessed items under R.C. 5739.02(B)(14). That subsection provides an exemption to purchases made by ships and vessels used principally in interstate commerce. Castle argues that an

airplane is included in and described by the term “vessel” when that term is given its ordinary meaning. The Tax Commissioner argues that including airplanes within the statutory exemption for ships and vessels traveling in interstate commerce again expands an exemption which is intended to be narrowly construed.

We must agree with the Tax Commissioner when he concludes that Castle’s claim should be denied. First, we agree that Castle is attempting to expand the terms “vessel” to include “airplane.” Even if we were to agree that the General Assembly intended to include aircraft serving interstate commerce, the record reflects that Castle provided transportation services throughout the state, portions of the country and some international flight services. However, nowhere in the record do we find a breakdown of the destination of flights and/or time spent within and without the state. Therefore, we must find that Castle’s claim fails both legally and factually.

Another claim is made under R.C. 5739.02(B)(33). That section exempts purchases of items attached to or incorporated into motor vehicles that are used in highway transportation for hire. Castle argues that the definition found within the licensing statutes would include aircraft. See R.C. 4501.01. However, the board finds that including aircraft under an exemption directed to motor vehicles unnecessarily expands an exemption from taxation. More importantly, however, the Supreme Court has determined this exemption applies only to motor vehicles when operating as common carriers. *Midwest Haulers, Inc.*, supra; *A. J.*

Weigand, Inc. v. Bowers (1960), 171 Ohio St. 78. As we have concluded that Castle’s business model is more closely aligned with contract carriage, the exemption would not be available to it.

Finally, Castle makes an equal protection claim under both the Fourteenth Amendment of the United States Constitution and Section 2, Article I, of the Ohio Constitution. Castle argues that to hold purchases of airlines regulated by Part 135 taxable but to exempt purchases of larger airlines regulated by Part 121 violates the protections afforded by both the state and federal constitutions. Castle cites *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195 in support of its claim.

MCI clarifies the board’s role when considering constitutional claims.

“The BTA understood its role to be a receiver of evidence for constitutional challenges. Accordingly, it did so, giving the parties wide latitude in presenting the evidence.

“***.

“In *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St.3d 229, ***, paragraph three of the syllabus, we held:

“The question of whether a tax statute is unconstitutional when applied to a particular state of facts must be raised in the notice of appeal to the Board of Tax Appeals, and the Board of Tax Appeals must receive evidence concerning this question if presented, even though the Board of Tax Appeals may not declare the statute unconstitutional. (*Bd. of Edn. of South-Western City Schools v. Kinney* [1986], 24 Ohio St.3d 184, *** construed.)’

“We explained the process, 35 Ohio St.3d at 232***:

“When a statute is challenged on the basis that it is unconstitutional in its application, this court needs a record, and the proponent of the constitutionality of the statute needs notice and an opportunity to offer testimony supporting his or her view.

“To accommodate this court's need for extrinsic facts and to provide a forum where such evidence may be received and all parties are apprised of the undertaking, it is reasonable that the BTA be that forum. The BTA is statutorily created to receive evidence in its role as factfinder.’

“*** Thus, the BTA receives evidence at its hearing, but we determine the facts necessary to resolve the constitutional question.” *Id.*, at 197, 198. (Parallel citations omitted.)

Given the court’s mandate, the board provided the parties a forum for introducing evidence regarding the constitutional question. Our role ends with the evidentiary hearing.

Considering the record foregoing, it is the finding of the Board of Tax Appeals that the assessment issued by the Tax Commissioner is correct. Therefore, the assignments of error asserted by Castle are overruled and the final determination is affirmed.

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