STATE OF WISCONSIN

TAX APPEALS COMMISSION

MARTIN L. AND SUSAN R. CRAMER, **DOCKET NO. 11-I-266**

Petitioners,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

RULING AND ORDER

LORNA HEMP BOLL, CHAIR:

This matter comes before the Commission on the Department's Motion for Summary Judgment. This case concerns an assessment the Department issued against the Petitioners for income taxes for the periods ending December 31, 2006, December 31, 2007, and December 31, 2008. The Petitioners are represented by Attorney Jonathan P. Reynolds and Daniel Cheung, CPA, of Aviation Tax Consultants, LLC, Columbus, Indiana. The Department is represented by Attorney Sheree Robertson. The parties have submitted a Stipulation of Facts and Issues. The parties have stipulated that the Commission may accept the stipulated facts as true for the purpose of the Department's pending Motion for Summary Judgment.[1]

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[1] Stipulation, p. 15.

FACTS[2]

Jurisdictional Facts

1. Under the date of August 30, 2010, the Department issued a Notice of Amount Due resulting from an assessment of additional income tax against Petitioners with adjustments being made to their reported income for the tax years ending December 31, 2006, December 31, 2007, and December 31, 2008. Per the Notice of Amount Due, the amount assessed is $24,237.06, including tax, interest, and UPI (underpayment interest). The Department of Revenue adjusted Petitioners' 2006 through 2008 Wisconsin individual income tax returns because it determined that the rental activity reported on the federal Schedule Cs is subject to the passive loss rules under § 469 of the Internal Revenue Code. (Stip. Ex. 1.)

2. On or about October 28, 2010, the Department received the Petitioners' Petition for Redetermination. In their Petition for Redetermination, Petitioners argued that the rental activity meets the exceptions under Treas. Regs. §§ 1.469-1T(e)(3)(ii)(A) and (E), because the average rental period is seven days or less, the aircraft was available nonexclusively to various pilots, and Petitioner Martin L. Cramer materially participated in the operation and marketing the aircraft. (Stip. Ex. 2.)

3. Under the date of July 28, 2011, by its Notice of Action letter, the Department of Revenue denied Petitioners' Petition for Redetermination. (Stip. Ex. 3.)

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[2] The facts are taken primarily from the relevant facts contained in the stipulation submitted by the parties, with some additions from the exhibits themselves.

4. On or about September 26, 2011, Petitioners filed a Petition for Review with the Wisconsin Tax Appeals Commission objecting to the Department of Revenue's action on their Petition for Redetermination. (Stip. Ex. 4.)

5. On or about October 24, 2011, the Department of Revenue filed with the Wisconsin Tax Appeals Commission an Answer to Petitioners' Petition for Review. (Stip. Ex. 5.)

6. On or about June 8, 2012, the Attorney for Petitioners, Jonathan P. Reynolds of Aviation Tax Consultants, LLC, filed with the Wisconsin Tax Appeals Commission Petitioners' "Supplemental Petition On Appeal." (Stip. Ex. 6.)

7. On or about June 15, 2012, the Department of Revenue filed with the Wisconsin Tax Appeals Commission an Answer to Petitioners' Supplemental Petition for Review. (Stip. Ex. 7.)

8. On December 5, 2012, the Commission received a Stipulation of Issues and Facts signed by both parties.

9. On December 6, 2012, the Department filed a Motion for Summary Judgment. Both parties have filed briefs in support of their respective positions.

Evidentiary Facts

10. Petitioners are residents of the State of Wisconsin and were residents in 2006 through 2008, subjecting them to the Wisconsin income tax laws. (Stip. ¶ 8.)

11. In 2006 through 2008 and years prior to and subsequent to them, Petitioner Martin L. Cramer worked full-time as a systems analyst. Petitioner Susan R. Cramer worked full-time as a college professor. (Stip. ¶ 9.)

12. Petitioner Martin L. Cramer[3] became a licensed private pilot on March 26, 2004, and continues to hold such license. As a licensed private pilot, Petitioner Martin L. Cramer is authorized to fly for noncommercial purposes. (Stip. ¶ 10.)

13. On May 15, 2006, Petitioners applied for a $240,000 loan from a lending institution for the purchase of an airplane. The Business Loan Application shows that the type of business is to "[r]ent plane time." Their loan application was subsequently approved. According to the Commercial Loan Agreement for the loan, dated June 16, 2006, it shows the loan name as Fly There, LLC ("Fly There"). Per the Commercial Loan Agreement, Petitioners agreed to repay the loan by July 1, 2009. (Stip. ¶ 11 and Ex. 8.)

14. Petitioner Martin L. Cramer registered Fly There as a limited liability company with the Wisconsin Department of Financial Institutions, which registration became effective June 6, 2006. Petitioner Martin L. Cramer is the sole owner of Fly There and is its registered agent. The mailing address of Fly There is Petitioners' home address. (Stip. ¶ 12.)

15. The invoice dated June 19, 2006, shows Petitioner Martin L. Cramer as the purchaser of the Cirrus SR20, ("Cirrus/Aircraft") from Cirrus Design Corporation, which he continues to own. The invoice also shows that the Cirrus is registered to Fly There. The Cirrus is a single engine aircraft with a seating capacity of four that has safety features including a parachute; a Global Positioning System (GPS); steering/autopilot; weather radar; high cruising speed; and the Cirrus Standardized Instructors Program

[3] "Petitioner" may be used in both the singular and plural throughout this decision. The singular is used because most of the activities and events described involve only Mr. Cramer, although Mrs. Cramer is a joint petitioner by virtue of their filing status and peripheral involvement.

(CSIP), which program/system is used to train flight instructors. The purchase order for the Cirrus shows the purchaser as Petitioner Martin L. Cramer for an unknown corporation name, and the Aircraft Order Addendum for the Cirrus was signed by Petitioner Martin L. Cramer and dated April 19, 2006. (Stip. ¶ 13 and Ex. 9)

16. On or about June 21, 2006, Petitioner Martin L. Cramer, as the President of Fly There, registered the Cirrus with the United States Department of Transportation, Federal Aviation Administration, reporting Fly There as the owner. The Aircraft Registration Application is signed by Petitioner Martin L. Cramer and dated June 21, 2006. (Stip. Ex. 10.)

17. On or about June 21, 2006, on behalf of Fly There, Petitioner Martin L. Cramer took delivery of the Cirrus from Cirrus Design Corporation at its headquarters in Duluth, Minnesota. Orion Flight Services, Inc. ("Orion"), had flight instructors who were certified on the CSIP system. While in Duluth, Minnesota, Petitioner Martin L. Cramer attended meetings on ground instructions, aircraft maintenance, procedures for technical support, and updating avionics. On or about June 26, 2006, a pilot/flight instructor for Orion flew the Cirrus from Duluth, Minnesota, to Oshkosh, Wisconsin, where it was placed with Orion. (Stip. ¶ 15.)

18. Orion was incorporated in Wisconsin in March 1997. Orion is a fixed based operator (FBO), which is defined by the Federal Aviation Administration as a commercial business granted the right by the airport sponsor to operate on an airport and provide aeronautical services such as fueling, hangaring, tie-down and parking, aircraft rental, aircraft maintenance, flight instructions, etc. Orion is a full service FBO located in

Oshkosh, Wisconsin. Orion operates a flight services business in Oshkosh, Wisconsin, which includes custom air charter, flight instruction, scenic air tours, aircraft rental, and ground support, which were services also offered in 2006 through 2008. (Stip. ¶ 16.)

19. Fly There (referred to as Owner) and Orion (referred to as Manager), on July 2, 2006, entered into a written Aircraft Management Agreement (Agreement), which Petitioner Martin L. Cramer signed as President of Fly There and Jeff Wanke signed as President of Orion. The Agreement was renewed annually for the years 2007 and 2008. (Stip. ¶17 and Ex. 11.)

20. Orion entered into the Agreement with Petitioner Martin L. Cramer for purposes of using the Cirrus in its flight services business, including aircraft charter, rental and flight instructions. Some of the provisions of the Agreement that were in effect during the tax years ending December 31, 2006, to December 31, 2008, are as follows:

> Article I, Section 1.01. Status.
> Manager shall perform its service hereunder in the status of an independent contractor. This Agreement has been entered into solely for those purposes set forth in this Agreement and nothing herein nor any performance made pursuant hereto shall be deemed or construed to create the relationship of principal and agent between Owner and Manager or any partnership, joint venture or other form of joint enterprise or entity between Manager and Owner.
>
> Article I, Section 1.02. Term and Cancellation. (in part)
> This Agreement shall have a primary term of one year commencing on the date of execution of this Agreement. Upon expiration of the primary term, this Agreement will remain in effect on a month-to-month basis. Either party may terminate this Agreement with a 60-day written notice. This Agreement may be extended or amended by mutual written consent.

Article I, Section 1.03. Operations.
Manager shall at all times maintain operational control of the Aircraft in accordance with FAR Part 135 and Part 91 when the Aircraft is operated in commercial operations under the authority of Manager's Air Carrier Certificate. The Owner shall maintain operational control for flights operated in the furtherance of the Owner's business as allowed under F.A.R. Part 91 regulations.

Article II, Section 2.04. Maintenance and Repair. (in part)
The Owner shall perform, or cause to be performed, all maintenance, repair, inspection, and overhaul work necessary to maintain Aircraft in accordance with the applicable regulations of the Federal Aviation Administration ("FAA").

Article II, Section 2.08. Responsibility for Operational Control. (in part)
Owner acknowledges that Manager has a priority interest in maintaining its Air Carrier Certificate in good standing with the FAA as well as its reputation in the air charter industry. During such times as Aircraft is operated under the authority of Manager's Air Carrier Certificate, Manager shall have and maintain operational control of Aircraft as defined in the FAA regulations, 14 C.F.R. Part 1 and Part 135.77. Therefore, Manager has the sole authority and discretion on approval of fights operated under the authority of its Air Carrier Certificate.

Article III, Section 3.01. Fees. (in part)
When the Aircraft is used in the furtherance of Manager's business, the Manager shall pay the Owner $180.00 per hour on the aircraft as measured by the flight-hour meter installed in the aircraft.

Article III, Section 3.02. Appointment. The expenses pursuant to the Agreement shall be paid by Owner and Manager as follows in this section:
(a) Except as otherwise herein specifically provided, Owner shall be responsible for all costs and expenses of operating, maintenance, modification, repair and inspection of the Aircraft, including parts, equipment, flight manuals, and any other expenses directly associated with the aircraft.

> (b) Owner shall pay promptly all taxes, fees, assessments, fines and penalties due, assessed or levied by any taxing authority or governmental agency that relate in any way to the operation of the Aircraft, including (without implied limitation) personal property taxes, all license and registration fees and all use, gross receipts, franchise, stamp fines or interest thereon imposed during the entire term f this Agreement. Manager shall be liable for all income taxes attributable to its own income payable hereunder and shall be responsible for collecting and submitting applicable Federal Excise Taxes, sales taxes, landing fees, service fees, and other taxes or fees incurred as a result of operating the Aircraft in Manager's operations[.]
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> Article III, Section 3.05. Fee Adjustment.
> During the term of this lease, the rental fee listed in Section 3.01 may be adjusted to reflect changes in the Owner's operating costs. The Owner agrees that the Manager retains sole discretion in setting Manager's retail rental and charter rates for the aircraft.
>
> Article VI, Section 6.13. Return of Plane to Owner.
> On termination of this Agreement by expiration or otherwise, Manager shall return the Aircraft to Owner in a good operating condition and appearance as when received, ordinary wear, tear, and deterioration excepted, and shall indemnify Owner against any claim for loss or damage occurring prior to the actual physical delivery of the Aircraft to Owner.

(Stip. Ex. 11.)

21. Under the terms and conditions of the Agreement and the annual renewals of it, in 2006 through 2008 Orion used the Cirrus in its flight services business, which included renting the Cirrus to its customers, including pilots; renting it for charter; and using it for flight instructions. Orion entered into agreements with its customers for the rental and/or charter of the Cirrus. Orion also entered into agreements with its customers for use of the Cirrus in-flight instructions. Neither Fly There nor Petitioner

Martin L. Cramer was a party to the agreements between Orion and its customers. Neither Fly There nor Petitioner Martin L. Cramer was involved in the negotiations of the agreements that Orion entered into with its customers. Orion was not required to obtain either Fly There or Petitioner Martin L. Cramer's prior approval before it negotiated and entered into agreements with its customers for use of the Cirrus. (Stip. ¶ 19.)

22. When the Cirrus was used in Orion's flight services business, Orion booked it without Fly There's and/or Petitioner Martin L. Cramer's prior approval. (Stip. ¶ 20.)

23. From June 26, 2006, through December 31, 2008, Petitioners hangared the Cirrus with Orion in Oshkosh, Wisconsin, which offered favorable rates for the hangar and discounts for fuel. (Stip. ¶ 21.)

24. Petitioner Martin L. Cramer gave Orion preference over the use of the Cirrus because he wanted it to generate revenue. (Stip. ¶ 22.)

25. The Cirrus has installed a Hobbs Meter which records the time the electrical power of an aircraft is on. The Hobbs Meter runs electrically, indicating hours and tenths of an hour. Hobbs Time is usually recorded in the pilot's logbook and many FBOs that rent airplanes charge an hourly rate based on Hobbs Time. For the years 2006 through 2008, under the terms and conditions of the Agreement and its renewals, Orion maintained records using Hobbs Time for its business use of the Cirrus. From June 26, 2006, to August 31, 2006, Orion created, prepared, and reported its business use of the Cirrus on a form titled "Cirrus SR20 N215SR Lease Payment Reconciliation." Orion also reported its use of the Cirrus from September 1, 2006, to December 31, 2008, on a form

titled "N12806 Aircraft Lease Reconcile." (Stip. Ex. 12.) The following tables summarize the information reported on the Lease Payment Reconciliation and Aircraft Lease Reconcile forms for the Cirrus that Orion prepared for the period from June 26, 2006, to December 31, 2008:

HOBBS TIME AND USER OF THE CIRRUS			
User	**2006**	**2007**	**2008**
Orion	73.9	179.4	205.2
Martin L. Cramer	11.1	39.1	29.1
TOTAL HOBBS TIME	85.0	218.5	234.3

Percentage of Orion's Hobbs Time to Total Hobbs Time	
2006	86.94%
2007	82.11%
2008	87.58%
Percentage of Martin L. Cramer's Hobbs Time to Total Hobbs Time	
2006	13.06%
2007	17.89%
2008	12.42%

(Stip. ¶ 23.)

26. Orion prepared all of the accounting records for use of the Cirrus in its flight services business, which includes those for charter, rental, and flight instructions. Neither Fly There nor Petitioner Martin L. Cramer was involved in the preparation and completion of any of Orion's accounting records, including the lease reconciliation reports. (Stip. ¶ 24.)

27. Orion controlled the cash flow for the Cirrus in its flight services business. Prior to 2008, Orion issued invoices to Fly There for the hangar and fuel costs for the Cirrus. Orion also issued checks to Fly There for the flight hours the Cirrus was used

in its flight services business in accordance with Section 3.01 of the Agreement. At some point in 2008, Orion changed its billing system for the Cirrus and began issuing credit memos to Fly There for the hangar and fuel costs. Orion continued to issue checks to Fly There for the flight hours the Cirrus was used in its business in accordance with Section 3.01 of the Agreement. (Stip. ¶ 25.)

28. The following is a summary of Petitioner Martin L. Cramer's involvement with Fly There: In March 2006, Petitioner Martin L. Cramer began researching the purchase of an aircraft, including financing it. In June 2006, he obtained financing for the purchase of the Cirrus and obtained an insurance policy for it as required for the loan. Also in June 2006, with the assistance of Aviation Tax Consultants, LLC, specifically Daniel Cheung, CPA, Petitioner Martin L. Cramer formed Fly There and completed the paperwork for registering Fly There with the Wisconsin Department of Financial Institutions. In 2006, 2007 and 2008, Petitioner Martin L. Cramer prepared the financial reports the bank required for the loan. (Stip. ¶ 26.)

29. Petitioner Martin L. Cramer tracked Fly There's income and expenditures in an accounting system. He also addressed the maintenance of the Cirrus. He kept for Fly There a logbook flight summary for the maintenance, marketing, and personal use of the Cirrus. In March 2010, Petitioner Martin L. Cramer informed the Department of Revenue that he worked about 120 hours a year at Fly There. In May 2012, Petitioner Martin L. Cramer informed the Department of Revenue that he worked the following hours at Fly There: in 2006, 152.5 hours, which includes 20.7 hours of travel time; in 2007, 119.6 hours, which includes 7.6 hours of travel time; in 2008, 121.6 hours,

which includes 13.0 hours of travel time. The travel time only includes ground travel. (Stip. ¶ 26.)

30. Petitioner Martin L. Cramer maintained a Logbook Summary for the Cirrus for the period from June 21, 2006, to December 31, 2008, showing the flight hours Fly There used it for business, personal use, maintenance, training and marketing. The training reported was for training of Orion flight instructors on the CSIP system and other training using the Cirrus. The training reported also included the training of Petitioner Martin L. Cramer on how to operate and fly the Cirrus. (Ex. 13.) Petitioner Martin L. Cramer first piloted the Circus on or about August 20, 2006. The following table summarizes the information in Fly There's logbook:

FLIGHT HOURS			
	2006	2007	2008
MARTIN L. CRAMER TRAINING	8.6	8.8	0
MARTIN L. CRAMER MAINTENANCE	0	5.3	5.1
MARTIN L. CRAMER PERSONAL	0	15.7	10.9
MARTIN L. CRAMER MARKETING	0	0	5.1
MARTIN L. CRAMER BUSINESS	0	0	1.2
TOTAL FLIGHT HOURS	8.6	29.8	22.3

The percentage of use of the Cirrus by Fly There for the above categories are set forth in the following table and are based on the total flight hours of 85.0 for 2006, 218.5 for 2007, and 234.3 for 2008:

PERCENTAGE OF USE BY FLY THERE			
	2006	2007	2008
MARTIN L. CRAMER TRAINING	10.12%	4.03%	0.00%
MARTIN L. CRAMER MAINTENANCE	0.00%	2.43%	2.18%
MARTIN L. CRAMER PERSONAL	0.00%	7.19%	4.65%
MARTIN L. CRAMER MARKETING	0.00%	0.00%	2.18%
MARTIN L. CRAMER BUSINESS	0.00%	0.00%	0.51%

(Stip. ¶ 27.)

31. During the period that Orion used the Cirrus in its flight services business, it established all charters and qualified them. Orion negotiated and drafted all paperwork related to the charters and/or rental of the Cirrus in its business. Orion prepared and completed all the accounting records related to its flight services business. Neither Fly There nor Petitioner Martin L. Cramer was involved in the preparation and completion of Orion's financial records. Orion negotiated with its customers the use of the Cirrus in the flight instruction portion of its business. Neither Fly There nor Petitioner Martin L. Cramer was involved in Orion flight instruction services. Petitioner Martin L. Cramer was not a member of Orion's marketing team. Petitioner Martin L. Cramer was not an employee and/or independent contractor of Orion. (Stip. ¶ 28.)

32. The Cirrus Design Corporation in a flyer promoted that the Cirrus would be available in late June 2006 for rental and flight instructions at Orion, whose contact information is listed in the flyer. Neither Fly There nor Petitioner Martin L.

Cramer is referenced in the flyer and no contact information for either is listed. (Stip., Ex. 14.) The Cirrus Design Corporation in another flyer also announced an open house to be held on October 20, 2006, at Orion. The open house was to give others an opportunity to look at the Cirrus for purposes of renting it. Neither Fly There nor Petitioner Martin L. Cramer is referenced in the flyer and no contact information for either is listed. (Stip., Ex. 15.) Orion marketed the rental or charter of the Cirrus in flyers that included its own contact information. Neither Fly There nor Petitioner Martin L. Cramer is referenced in the flyers and no contact information for either is listed. In small print at the bottom of the flyers, they show that the brochures are copyrighted by Fly There and Steven Cramer. (Stip. Ex. 16.)

33. The federal Department of Transportation, Federal Aviation Administration, issued to Orion an Air Carrier Certificate under Title 14 CFR Part 135, which allowed it to charter the Cirrus to its customers for commuter or on-demand operations in 2006 through 2008. Orion, as a certified air carrier, could transport up to nine people by air from one point to another point. Petitioner Martin L. Cramer could not have flown the Cirrus under Orion's Air Carrier Certificate because he did not have a commercial pilot license and could not transport others for hire or on demand operations. Neither Fly There nor Petitioner Martin L. Cramer had an Air Carrier Certificate under Title 14 CFR Part 135 in 2006, 2007 and 2008. (Stip. ¶ 30.)

34. A certificate issued by the Federal Aviation Administration under Title 14 CFR Part 91 allows a pilot to transport others by aircraft without hire, a noncommercial transport. Petitioner Martin L. Cramer has never held the certificate

required by the Federal Aviation Administration that would have allowed him to provide flight instructions to others for hire. Orion had the certificate that allowed it to charter the Cirrus to other pilots. Orion also held the certificate that allowed it to give flight instructions to others. (Stip. ¶ 31.)

35. In 2006, Petitioner Martin L. Cramer worked part of the year for Virchow Krause & Co. and had taxable wages of $29,931. He also worked part of year in 2006 for Business Technology Systems, Inc., and had taxable wages of $27,351. In 2006, Petitioner Susan R. Cramer worked for the University of Wisconsin System and had taxable wages of $51,503. (Stip. ¶ 32.)

36. Petitioners jointly filed a 2006 Wisconsin individual income tax return with a federal Schedule C attached. The federal Schedule C shows Fly There's principal activity is "Cirrus airplane leas" [sic]. On the federal Schedule C, Petitioner Martin L. Cramer is listed as the proprietor of the leasing activity. Petitioners reported on the federal Schedule C gross receipts of $10,687, total expenses of $98,832, and a net loss of $87,497. (Stip. Ex. 17.)

37. In 2007, Petitioner Martin L. Cramer was employed by Business Technology Systems, Inc., and had taxable wages of $42,249.28. In 2007, Petitioner Susan R. Cramer was employed by the University of Wisconsin System and had taxable wages of $57,899.42. (Stip. ¶ 34.)

38. Petitioners jointly filed a 2007 Wisconsin individual income tax return with a federal Schedule C attached. On the federal Schedule C, Petitioner Martin L. Cramer is listed as the proprietor of Fly There, whose principal activity is "Cirrus Airplane

leasing." On the federal Schedule C, Petitioners reported gross receipts of $30,362, total expenses of $138,397, and a net loss of $106,529. (Stip. Ex. 18.)

39. Petitioners jointly filed a 2008 Wisconsin individual income tax return with a federal Schedule C attached. Petitioners' 2008 Wisconsin individual income tax return shows W-2 wages of $91,099 included in line 1. Petitioners did not attach wage statements to their Wisconsin individual income tax return. On the federal Schedule C, Petitioner Martin L. Cramer is listed as the proprietor of Fly There, whose principal activity is "Cirrus Airplane Leasing." On the federal Schedule C, Petitioners reported gross receipts of $30,204, total expenses of $107,993, and a net loss of $77,609. (Stip. Ex. 19.)

40. In August 2012, Petitioners submitted to the Department of Revenue the monthly general ledger fixed/variable expenses for the Cirrus for the years 2006, 2007 and 2008. (Stip. ¶ 37 and Ex. 20.)

41. Fly There paid Wisconsin sales tax on Petitioner Martin L. Cramer's personal use of the Cirrus. Per the general ledgers for Fly There's fixed/variable monthly expenses, in 2006, Wisconsin sales tax of $45 was paid; in 2007, Wisconsin sales tax of $101 was paid; and in 2008, Wisconsin sales tax of $180 was paid. Neither Petitioner Martin L. Cramer nor Fly There paid Wisconsin sales tax when Orion used the Cirrus in its flight services business. Orion paid the Wisconsin sales tax due on the gross receipts collected from the rental activity of the Cirrus. (Stip. ¶ 39.)

42. In 2006, 2007 and 2008, Fly There was Petitioner Martin L. Cramer's only federal Schedule C activity. (Stip. ¶ 40.)

43. Petitioner Martin L. Cramer made the decision to change Fly There's FBO from Orion to Frontline Aviation, Inc., located in Green Bay, Wisconsin. Petitioner Martin L. Cramer, on behalf of Fly There, and Frontline Aviation, Inc., entered into a written Aircraft Lease for the lease of the Cirrus, which lease term began on June 30, 2009, and expired on June 30, 2010. (Stip. ¶ 41, Ex. 21.)

44. For the tax year ending December 31, 2009, Petitioner Martin L. Cramer began reporting Fly There as a passive activity for income tax purposes. (Stip. ¶ 43.)

STIPULATED ISSUES

The parties agree that the Wisconsin Tax Appeals Commission may accept the Stipulation of Issues and Facts involved in this proceeding without hearing or the presentation of further evidence. The parties further agree to the admission into evidence of all exhibits referenced in the Stipulation of Issues and Facts. The Stipulated Issues are as follows:

1. Whether the Agreement between Fly There, LLC, and Orion Flight Services, Inc., is a lease or management agreement for a Cirrus Aircraft.

2. Whether losses from the rental activity reported on the federal Schedule Cs attached to Petitioners' 2006 through 2008 Wisconsin individual income tax returns are limited to the passive loss rules.

3. Whether Petitioners' federal Schedule C activity comes within the exceptions set forth in Treas. Regs. §§ 1.469-1T(e)(3)(ii) (C) and (E).

Petitioners' Contentions

It is Petitioners' contention that the Agreement between Fly There and Orion is a management agreement and not a lease agreement. Based on that distinction, Petitioners further contend that the federal Schedule C activity related to Fly There is not limited to the passive loss rules in 2006, 2007 and 2008. Petitioners also contend that they meet the exceptions under Treas. Regs. §§ 1.469-1T(e)(3)(ii)(C) and (E). (Stip. ¶ 44.)

The Department's Contentions

The Department of Revenue contends that the Agreement between Fly There and Orion is a lease agreement and not a management agreement. The Department of Revenue also takes the position that the losses Petitioners claimed on their 2006 through 2008 federal Schedule Cs for the airplane leasing activity are limited by the passive loss rules. It is the Department of Revenue's further position that Petitioners do not meet any exception to the passive loss rules. (Stip. ¶ 45.)

APPLICABLE LAW

I.R.C § 469
(c) Passive activity defined
For purposes of this section –
(1) In general. The term "passive activity" means any activity –
(A) which involves the conduct of any trade or business, and
(B) in which the taxpayer does not materially participate.
(2) Passive activity includes any rental activity
Except as provided in paragraph (7), the term "passive activity" includes any rental activity.
(7) Special rules for taxpayers in real property business
(text omitted as this case does not involve real property)

Treas. Reg. § Subchapter A, Sec. 1.469-1T

(e) *Definition of "passive activity"* –

(1) *In general.* Except as otherwise provided in this paragraph (e), an activity is a passive activity of the taxpayer for a taxable year if and only if the activity –

(i) Is a trade or business activity (within the meaning of paragraph (e)(2) of this section) in which the taxpayer does not materially participate for such taxable year; or

(ii) Is a rental activity (within the meaning of paragraph (e)(3) of this section), without regard to whether or to what extent the taxpayer participates in such activity.

. . .

(3) *Rental activity* –

(i) *In general.* Except as otherwise provided in this paragraph (e)(3), an activity is a rental activity for a taxable year if –

(A) During such taxable year, tangible property held in connection with the activity is used by customers or held for use by customers; and

(B) The gross income attributable to the conduct of the activity during such taxable year represents (or, in the case of an activity in which property is held for use by customers, the expected gross income from the conduct of the activity will represent) amounts paid or to be paid principally for the use of such tangible property (without regard to whether the use of the property by customers is pursuant to a lease or pursuant to a service contract or other arrangement that is not denominated a lease).

(ii) *Exceptions.* For purposes of this paragraph (e)(3), an activity involving the use of tangible property is not a rental activity for a taxable year if for such taxable year –

(A) The average period of customer use for such property is seven days or less;

(B) The average period of customer use for such property is 30 days or less, and significant personal services (within the meaning of paragraph (e)(3)(iv) of this section) are provided by or on behalf of the owner of the property in

connection with making the property available for use by customers;

(C) Extraordinary personal services (within the meaning of paragraph (e)(3)(v) of this section) are provided by or on behalf of the owner of the property in connection with making such property available for use by customers (without regard to the average period of customer use);

(D) The rental of such property is treated as incidental to a nonrental activity of the taxpayer under paragraph (e)(3)(vi) of this section;

(E) The taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers; or

(F) The provision of the property for use in an activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an interest is not a rental activity under paragraph (e)(3)(vii) of this section.

. . .

(v) *Extraordinary personal services.* For purposes of paragraph (e)(3)(ii)(C) of this section, extraordinary personal services are provided in connection with making property available for use by customers only if the services provided in connection with the use of the property are performed by individuals, and the use by customers of the property is incidental to their receipt of such services. For example, the use by patients of a hospital's boarding facilities generally is incidental to their receipt of the personal services provided by the hospital's medical and nursing staff. Similarly, the use by students of a boarding school's dormitories generally is incidental to their receipt of the personal services provided by the school's teaching staff.

(vi) *Rental of property incidental to a nonrental activity of the taxpayer—*

. . .

(C) *Property used in a trade or business.* The rental of property during a taxable year shall be treated as incidental to a trade or business activity (within

> the meaning of paragraph (e)(2) of this section) if and only if—
>
> (*1*) The taxpayer owns an interest in such trade or business activity during the taxable year;
>
> (2) The property was predominantly used in such trade or business activity during the taxable year or during at least two of the five taxable years that immediately precede the taxable year; and
>
> (*3*) The gross rental income from such property for the taxable year is less than two percent of the lesser of—
>
> (*i*) The unadjusted basis of such property; and
>
> (*ii*) The fair market value of such property.

OPINION

IRC § 162 allows deductions for ordinary and necessary expenses incurred in carrying on a trade or business. IRC § 212 allows deductions for ordinary and necessary expenses incurred for the production of income or management or maintenance of property held for the production of income. Deductions for losses from passive activities are limited by the passive loss rules of IRC § 469. Section 469(c)(1) defines "passive activity" as any activity which involves the conduct of any trade or business, and in which the taxpayer does not materially participate.

The code further states that rental activities are generally considered passive regardless of whether the taxpayer materially participates. IRC § 469(c)(2)[4] and

[4] IRC § 469(c)(2) states, "Passive activity includes any rental activity. Except as provided in paragraph (7), the term "passive activity" includes any rental activity."

IRC § 469(c)(4).[5] Because rental activity is generally considered a passive activity, our analysis must begin with the threshold question:

Is Petitioner's Activity "Rental Activity" So As To Fall Generally Under The Passive Rules For Rental Activity?

Under IRC § 469(c)(2), the passive losses include those from "any rental activity." One specific exception to the passive loss rule of IRC § 469(c)(2) is listed in IRC § 469(c)(7), which states that the rule may not apply to "rental real estate activity." The aircraft at issue in this case is not "real estate" and therefore the exception of subsection (7) does not apply. *See Kelly v. Commissioner*, 79 T.C.M. (CCH) 1427 (2000).

We turn next to the Treasury Regulations, specifically Treas. Reg. § 1.469-1(e)(1) which mirrors the IRC rule stating that an activity is passive if it is a rental activity, regardless of the extent of the taxpayer's participation. The regulations further provide that an activity is a rental activity if "tangible property held in connection with the activity is used by customers or held for use by customers" and where "the gross income attributable to the conduct of the activity during such taxable year represents . . . amounts paid or to be paid principally for the use of such tangible property (without regard to whether the use of the property by customers is pursuant to a lease or pursuant to a service contract or other arrangement that is not denominated a lease)." Treas. Reg. § 1.469-1(e)(3)(i).

[5] IRC §469(c)(4) states, "Material participation not required for paragraphs (2) and (3). Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity." For that reason, it is not necessary to consider the issue of material participation, although both parties presented arguments on that issue.

Before we address the issues submitted by the parties, we first find as follows: The Cirrus is "tangible property" held in connection with the Petitioner's activity, and the Cirrus is "used by customers or held for use by customers." The income from the activity reflects amounts "paid principally for the use of" the Cirrus. Thus, we find that the activity in question is rental activity.

Stipulated Issue 1.
Is The Agreement A Lease?

The Petitioner's sole proprietor business, Fly There, is described as Owner, and Orion is described as Manager in the Agreement. The Agreement, entitled "Aircraft Management Agreement" was for an initial term of one year beginning June of 2006; the Agreement was renewed for the years 2007 and 2008. (Stip., ¶ 17.) If this Agreement is indeed a lease, the rental activity is between the Petitioner and Orion and spans one year, renewed annually during the periods at issue. If the Agreement is not a lease, then the rental activity is arguably a series of short-term rentals to the individual customers with whom Orion contracted.

In June of 2006, Petitioner purchased the Cirrus, registered the Cirrus with Fly There as its owner, took delivery of the Cirrus in Duluth, Minnesota, and arranged for Orion to fly the Cirrus from Duluth to Orion's place of business. Very shortly thereafter, the parties entered into the Aircraft Management Agreement ("Agreement") which had an initial one-year term. That Agreement was renewed in 2007 and again in 2008.

The Agreement begins by setting forth that the Manager (Orion) is not an agent for the Owner (Fly There, owned by Petitioner), nor does the Agreement set up a joint venture or any other type of joint enterprise. (Agreement, Article 1, Section 1.01, Status.)

Under the Wisconsin Uniform Commercial Code § 411.103(1)(j) "Lease" means a "transfer of the right to possession and use of goods for a term in return for consideration." Subsection 411.103(1)(k) of the Code goes on to state, "'Lease agreement' means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter."

The title of the Agreement does not necessarily control. *Crown Life Ins. Co. v. LaBonte*, 111 Wis. 2d 26, 36, 330 N.W.2d 201, 206 (1983) ("[U]sing contract law principles, the meaning of a particular provision in a contract is to be determined by looking at the whole contract.") The true nature of the Agreement can be found first through the language of the Agreement and, if ambiguous, through the circumstances surrounding the realities of the relationship between the parties.[6] *In Matter of Estate of Alexander*, 75 Wis. 2d 168, 181 (1977) ("The best indicator of the intent of the parties is the language of the contract itself.")

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[6] *See also Belk v. Commissioner*, U.S. Tax Court, CCH Dec. 59,570(M), T.C. Memo. 2013-154, 105 T.C.M. 1878, (Jun. 19, 2013) ("The parties' intention controls when interpreting a contract. We determined [] the parties' intent, as it appeared from all the provisions [of the agreement] . . . .")

The language used in the Agreement consistently refers to the arrangement between the parties as a lease. The performance of the Agreement appears to fall within the meaning of "lease agreement" as well. Petitioner transferred the right of possession and use of the Cirrus for a renewable one-year term to Orion in return for remuneration of $180 per flight hour. (Agreement, Article II, Section 3.01, Fees.) The Agreement sets provisions regarding the return of the aircraft to the Owner at the expiration of the lease. (Article VI, Section 6.13, Return of Plane to Owner.) On his tax returns for the years at issue Petitioner himself describes the activity at issue as "Cirrus airplane leas" [sic] (2006), "Cirrus Airplane leasing" (2007), "Cirrus Airplane Leasing" (2008), and himself as a "proprietor of leasing activity". Petitioner's subsequent arrangement with Frontline Aviation is substantially similar, is referred to as a lease, and is reported as a passive activity by the Petitioners.

Petitioners attempt to characterize the Agreement's purpose as management and marketing of the Cirrus. The marketing done by Orion was done in furtherance of its own flight services business; neither Petitioner's name nor the name of Fly There was mentioned in the Orion marketing flyers. Petitioner may also have engaged in some marketing activity, separate from the efforts of Orion. Those efforts if successful would have gained more business for Orion which in turn would have meant more flight hour income for the Petitioner. Such activities would have been incidental to the leasing activity which is clearly the primary purpose of the Agreement. Petitioner's own use of the aircraft by Petitioner was a miniscule amount percentage of

the total use of the aircraft, and that small percentage of use was primarily for his own training or personal use.

The Agreement gave Orion had full control and authority to rent the Cirrus to customers and to provide charters and flight instruction. The Cirrus' activities were governed by contracts between Orion and its customers in the furtherance of Orion's flight services business. Orion had sole authority and discretion on approval of flights it operated under its Air Carrier Certificate. Orion had full authority to set retail rental and charter rates. Petitioners were not a party to the contracts between Orion and its customers. The Petitioner did not have the qualifications to fly charters or to provide flight instruction himself.

We find from the stipulated facts that the ultimate users[7] of the Cirrus, either as charters or for flight instruction, were customers of Orion in conjunction with Orion's flight services business. Orion in turn was leasing the Cirrus from Petitioners, paying Petitioners in keeping with the terms of the contract $180 per flight hour, regardless of what Orion's customers were paying Orion.

Stipulated Issue 2.
Are Petitioners' Losses
Limited By Passive Loss Rules?

As noted above, generally rental activity is considered passive. Thus, because we find the activity to be rental activity between Petitioners and Orion, the losses Petitioners sustained are limited by the passive loss rules.

[7] It should be noted that Petitioner also used the aircraft for personal use and training although that use accounted for a small percentage of the use of the Cirrus.

Stipulated Issue 3.
Does The Petitioners' Schedule C Activity Fall Within The Treasury Regulation Exceptions?

The tax laws set forth several exceptions to application of the passive loss rules. The parties focus particularly on subsections (C) and (E) of Treas. Reg. § 1.469-1T(e)(3)(ii), but in the interest of completeness, we will address each potential exception in turn.

Subsection A: Given our holding that the rental activity between Petitioners and Orion is for annual periods, the 7-days-or-less rental period exception of subsection (A) also does not apply. The U.S. Tax Court has established that, when an owner leases property to a party who subsequently rents that property to others, the lease is what controls. For example, *Kelly v. Commissioner*, 79 T.C.M. (CCH) 1427 (2000), involved aircraft leased to a company which in turn rented them out or used them for flight instruction. As with the Petitioner, the aircraft owner in *Kelly* did not have a commercial pilot's license and could not give flight instruction. The company scheduled all flights and lessons. Although much of the responsibility including maintenance fell on the company, the owner spent at least 500 hours per year on the activity. The Tax Court concluded the deciding factor was the lease between the owner and the company. Because that lease was for a one-year term, the 7-day exception did not apply.

In this case as well, the lease is for a one-year period – well beyond the 7-day exception.

Subsection B: Similarly, the 30-days-or-less rental period exception of subsection (B) also does not apply to the circumstances of this case.

Subsection C: This exception applies in situations in which the taxpayer provides extraordinary personal services and the rental activity is incidental to those services.

> *Extraordinary personal services.* For purposes of paragraph (e)(3)(ii)(C) of this section, extraordinary personal services are provided in connection with making property available for use by customers only if the services provided in connection with the use of the property are performed by individuals, and the use by customers of the property is incidental to their receipt of such services.

The regulation itself goes on to clarify the intent of the exception:

> For example, the use by patients of a hospital's boarding facilities generally is incidental to their receipt of the personal services provided by the hospital's medical and nursing staff. Similarly, the use by students of a boarding school's dormitories generally is incidental to their receipt of the personal services provided by the school's teaching staff.

In this case, the aircraft was used for Orion's flight services business. Orion was the contact listed on the marketing flyers. Orion set the retail charges. Orion established all charters and rentals and negotiated with all customers for the use of the Cirrus in flight instruction. Orion performed all day-to-day operations regarding the charter and use of the Cirrus.

In contrast, the Petitioner researched, financed, purchased, and registered the aircraft. Those activities were all related to setting up the business. From there, the Petitioner was responsible for insuring and maintaining the aircraft and for preparing

financial reports required by the lender. In addition, he kept a logbook flight summary for maintenance, marketing, and personal use of the Cirrus. He was not a member of Orion's marketing team, although Petitioner does claim to have done some marketing as well in the form of attending expos, putting on demonstrations, and holding open houses. Petitioner did not hold a commercial pilot's license so he could not have transported passengers himself for hire, nor did he hold the qualifications to provide flight instructions.

Petitioner's activities were not extraordinary personal services which contributed to the rental of the Cirrus. Arguably some customers may have used the Cirrus in response to some of the marketing done by the Petitioner. However, we cannot conclude that anyone used the Cirrus to obtain the personal services provided by the Petitioner in the same manner as one uses a hospital room in order to obtain medical services. In fact, Petitioner's services were incidental to the rental of the aircraft, not the reverse. Thus, we find subsection (C) does not apply.

Subsection D: Like the preceding subsection, this exception requires that the rental of the property be treated as incidental to a nonrental activity of the taxpayer. We cannot find that customers rented the aircraft in order to obtain the services provided by the Petitioner. Customers do not choose an aircraft based on its owner's ability to obtain insurance, his wisdom in choosing a particular insurance company, or his accuracy in keeping his log books. Even his maintenance of the airplane is incidental. A customer expects an aircraft to be clean and safe. Instead, those services were incidental to the rental activity. Thus, Subsection (D) does not apply.

Subsection E: There is an exception when the rental activity is during defined business hours for nonexclusive use by various customers. Case law has established that this subsection is meant to apply in situations in which multiple users can use the rental property simultaneously. The example cited in the Regulations[8] shows how the exception applies to golf courses, where many users are "renting" the course at the same time. In contrast and more on point to this case, a U.S. District Court has explained,

> Chartering an airplane gives that particular customer *exclusive* use of the plane during the time the customer is using the plane, similar to renting a car. Chartering an airplane is not analogous to "renting" use of a golf course, where many people are using the same property at the same time.

Kenvill v. U.S., 97-2 T.C. ¶ 50,936 (N.D. 1997).

Applying *Kenvill*, we find that Subsection (E)'s exception does not apply.

Subsection F: An exception exists for activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an interest. The Agreement in this case makes it clear that no such relationship existed between the Petitioner and Orion.

> . . . nothing herein nor any performance made pursuant hereto shall be deemed or construed to create the relationship of principal and agent between Owner and Manager or any

[8] Treas. Reg. § 1.469-1(e)(2)(ii)(E). *Example (10).* The taxpayer operates a golf course. Some customers of the golf course pay green fees upon each use of the golf course, while other customers purchase weekly, monthly, or annual passes. The golf course is open to all customers from sunrise to sunset every day of the year except certain holidays and days on which the taxpayer determines that the course is too wet for play. The taxpayer thus makes the golf course available during prescribed hours for nonexclusive use by various customers. Accordingly, under paragraph (e)(3)(ii)(E) of this section, the taxpayer is not engaged in a rental activity, without regard to the average period of customer use for the golf course.

> partnership, joint venture or other form of joint enterprise or entity between Manager and Owner.

(Stip., Ex. 11, Article I, Section 1.01, Status.)

Petitioner had no ownership in Orion, nor was he in any form of partnership or joint venture with Orion. Orion contracted independently with customers to use the aircraft. Orion separately compensated Petitioner per the terms of their Agreement. Thus, we find that Subsection (F) does not apply.

CONCLUSIONS OF LAW

1. Petitioner's arrangement with Orion was a rental activity.

2. Petitioner's Agreement with Orion was a lease.

3. Petitioner did not provide extraordinary services in conjunction with the activity involving the Cirrus aircraft.

4. Petitioner's personal services were incidental to the rental use of the aircraft, not the reverse.

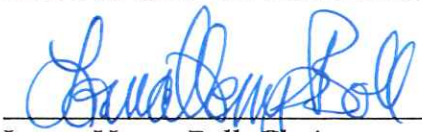
5. The activity does not fall under any of the exceptions to the passive loss rules. Therefore, the passive loss rules apply.

DECISION AND ORDER

There being no issues of material fact and based on the foregoing, it is the order of this Commission that the Department's Motion for Summary Judgment is granted and Petitioners' Petition for Review is dismissed.

Dated at Madison, Wisconsin, this 30th day of October, 2013.

WISCONSIN TAX APPEALS COMMISSION



Lorna Hemp Boll, Chair

Roger W. LeGrand, Commissioner

ATTACHMENT: **NOTICE OF APPEAL INFORMATION**

WISCONSIN TAX APPEALS COMMISSION
5005 University Avenue - Suite 110
Madison, Wisconsin - 53705

NOTICE OF APPEAL INFORMATION

NOTICE OF RIGHTS FOR REHEARING OR JUDICIAL REVIEW, THE TIMES ALLOWED FOR EACH, AND THE IDENTIFICATION OF THE PARTY TO BE NAMED AS RESPONDENT

A taxpayer has two options after receiving a Commission final decision:

Option 1: PETITION FOR REHEARING BEFORE THE COMMISSION

The taxpayer has a right to petition for a rehearing of a final decision within 20 days of the service of this decision, as provided in Wis. Stat. § 227.49. The 20-day period commences the day after personal service on the taxpayer or on the date the Commission issued its original decision to the taxpayer. The petition for rehearing should be filed with the Tax Appeals Commission and served upon the other party (which usually is the Department of Revenue). The Petition for Rehearing can be served either in-person, by USPS, or by courier; however, the filing must arrive at the Commission within the 20-day timeframe of the order to be accepted. Alternatively, the taxpayer can appeal this decision directly to circuit court through the filing of a petition for judicial review. It is not necessary to petition for a rehearing first.

AND/OR

Option 2: PETITION FOR JUDICIAL REVIEW

Wis. Stat. § 227.53 provides for judicial review of a final decision. Several points about starting a case:

1. **The petition must be filed in the appropriate county circuit court and served upon the Tax Appeals Commission either in-person, by certified mail, or by courier, and served upon the other party (which usually is the Department of Revenue)** within 30 days of this decision if there has been no petition for rehearing, or within 30 days of service of the order that decides a timely petition for rehearing.

2. If a party files a late petition for rehearing, the 30-day period for judicial review starts on the date the Commission issued its original decision to the taxpayer.

3. The 30-day period starts the day after personal service or the day we mail the decision.

4. **The petition for judicial review should name the other party (which is usually the Department of Revenue) as the Respondent, but not the Commission, which is not a party.**

For more information about the other requirements for commencing an appeal to the circuit court, you may wish to contact the clerk of the appropriate circuit court or the Wisconsin Statutes. The website for the courts is *http://wicourts.gov*.

This notice is part of the decision and incorporated therein.