STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
WRBC TRANSPORTATION, INC. **WILLIAM R. BERKLEY** **EUGENE G. BALLARD** **IRA S. LEDERMAN** **AND CLEMENT P. PATAFIO**	:	DETERMINATION DTA NOS. 822722, 822723, 822724, 822725 AND 822726
For Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2003 through February 28, 2007.	:	

Petitioners, WRBC Transportation, Inc., William R. Berkley, Eugene G. Ballard, Ira S. Lederman and Clement P. Patafio, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2003 through February 28, 2007.

A consolidated hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on October 8, 2009 at 10:30 A.M., with all briefs to be submitted by March 26, 2010, which date began the six-month period for the issuance of this determination. Petitioners appeared by Wilkie Farr & Gallagher, LLP (Joseph T. Baio, Esq., Megan Y. Hogan, Esq., and Meredith Levy,

Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel).[1]

ISSUES

I. Whether the Division of Taxation has established that petitioner WRBC Transportation, Inc., a corporate entity, should be disregarded and its sole shareholder held liable for the sales or use tax due under the "alter ego" theory.

II. Whether the Division of Taxation has established that petitioner should be disregarded as a corporation thereby permitting it to "pierce the corporate veil" and hold petitioner's sole shareholder liable for the sales or use tax due.

III. Whether the notices of determination should be canceled as a result of the Division of Taxation asserting for the first time in its brief a new theory on which it relies for the assertion of tax due.

IV. Whether petitioners have demonstrated reasonable cause for the abatement of penalty asserted by the Division of Taxation pursuant to Tax Law § 1145.

FINDINGS OF FACT

1. On September 1, 1983, Finevest Services Leasing Corporation was incorporated in Delaware. Finevest was authorized to issue 1,000 shares of common stock with a par value of $1.00 per share. It was incorporated for the general purpose of engaging in "any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware." In February 1991, Finevest changed its name to Interlaken Capital Aviation Services,

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[1] Petitioners William R. Berkley, Eugene G. Ballard, Ira S. Lederman and Clement P. Patafio appear in this proceeding because of their status as officers of petitioner WRBC Transportation, Inc. These individuals do not contest their status or resulting liability for any tax determined to be due herein from petitioner WRBC Transportation, Inc. Accordingly, references to petitioner shall mean petitioner WRBC Transportation, Inc., unless otherwise specified or required by context.

Inc., and on December 23, 1993, Interlaken changed its name to WRBC Transportation, Inc. (petitioner). Petitioner William R. Berkley was the president and 100% shareholder of Finevest Services Leasing Corporation, Interlaken Capital Aviation Services, Inc., and petitioner.

2. On December 17, 1993, Aviation Services Acquisition Corporation was incorporated in Delaware. On December 23, 1993, Aviation Services Acquisition Corporation changed its name to Interlaken Capital Aviation Services, Inc. (Interlaken). Mr. Berkley was the 100% shareholder of the corporation.

3. On January 1, 1994, petitioner transferred to Interlaken all of its assets, except a Falcon 900 airplane and all spare parts, accessories, protective covers, records and manuals held or maintained in connection with such airplane.

4. On January 4, 1994, William R. Berkley sold for $.01 per share each of the 1,000 outstanding shares of petitioner's stock he held to W. R. Berkley Corporation, Inc. (WRBC) for a total amount of $10.00. WRBC is a financial services company focused on the property and casualty insurance business. Petitioner is solely involved in the business of providing transportation services.

5. On February 16, 1996, Interlaken Capital Aviation Holdings, Inc. (ICAH) was incorporated in Delaware. On February 21, 1996, Mr. Berkley was named the president of ICAH. Also on the same date, ICAH issued to Mr. Berkley 1,000 shares of common stock in exchange for Mr. Berkley transferring 1,000 shares of the common stock of Interlaken. On February 23, 1996, Mr. Berkley sold all of the outstanding shares of ICAH to petitioner.

6. As a result of these transactions, WRBC was the 100% shareholder of petitioner and petitioner owned 100% of the shares of ICAH, which in turn owned 100% of the outstanding shares of Interlaken. The chairman of the board, president and chief executive officer of WRBC

was Mr. Berkley. The directors of petitioner were petitioners William R. Berkley, Eugene G. Ballard and Clement P. Patafio, and its officers were Mr. Berkley, as president, Mr. Ballard, as senior vice-president and treasurer, Mr. Patafio, as vice-president and Mr. Lederman as senior vice-president and secretary. The board of directors of both ICAH and Interlaken were Mr. Berkley and Mr. Ballard. Mr. Berkley was chairman of the board, president and chief executive officer of ICAH while Mr. Ballard served as its senior vice-president, secretary and treasurer. Mr. Berkley was also the chairman of the board, president and chief executive officer of Interlaken. The other officers were Mr. Ballard, as senior vice-president and treasurer, Mr. Patafio, as vice-president and controller, and Mr. Lederman, as senior-vice-president and secretary.

7. On October 13, 2006, the Division of Taxation (Division) mailed to petitioner an appointment letter stating that a sales and use tax field audit was to be performed for the period March 1, 2003 through February 28, 2006. Accompanying the letter was a records requested list detailing the records the Division required to perform the audit. On April 17, 2007, the Division sent a second letter to petitioner stating that the audit period had been expanded to March 1, 2003 through February 28, 2007. This letter was also accompanied by a records requested list. Petitioner made available books and records to the auditor sufficient for the performance of a detailed audit. The auditor reviewed the books and records of petitioner in the areas of capital acquisitions, sales and expenses.

8. During the audit period petitioner was located in Greenwich, Connecticut. In December 2004, petitioner purchased a 1998 Sikorsky S-76 helicopter from CIGNA Corporation for $5,100,000.00. On March 2, 2006, petitioner purchased a 2001 Falcon Jet from Leading Edge Aviation Solutions, LLC, for $19,750,000.00. Both aircraft are registered under

petitioner's name and are stored and operated out of the Westchester County Airport in a hangar owned by Interlaken. The funds for the purchases of the Sikorsky helicopter and the Falcon Jet (Aircraft) were provided by WRBC. Sales or use tax was not reported or paid on the purchase of the Aircraft.

9. The auditor reviewed petitioner's charges for flights to WRBC, as no other entity was billed. The charges were considered revenue to petitioner and expenses to WRBC on their respective books and records, although there was no transfer of funds. Compensation on petitioner's books from WRBC did not cover all the variable expenses of the Aircraft. The charges were computed by multiplying the number of flight hours by a fixed rate. The fixed rate was determined on a yearly basis and was based upon the variable costs of operating the Aircraft for the previous year. The fixed rate was computed by the accounting personnel of Interlaken. Certain fixed costs were not included in the computation of the fixed rate, such as Aircraft operating overhead, insurance for the Aircraft, the cost of the hangar for the Aircraft, the operating costs of the hangar, management fees and depreciation. No compensation was actually paid to petitioner. Revenue and expenses were reported by way of journal entries, which were eliminated when the entities' federal returns were consolidated. Petitioner had no bank accounts, and there was no direct compensation for the use of the Aircraft by WRBC. The auditor determined that petitioner was not reporting any taxable sales and that no sales tax was due in the area of sales.

10. In the area of expenses, the auditor reviewed petitioner's operating expenses, maintenance costs, charts, manuals and catering. Pursuant to a Test Period Audit Election Form signed by petitioner, the auditor reviewed the expense purchases for the year 2006. To avoid duplication, certain items, such as fuel, and certain maintenance contracts were reviewed in

detail. The auditor's review determined additional taxable expense purchases of $1,114,759.29 and additional tax due of $82,167.03. Petitioner agreed to pay the sales tax due on the fuel and the use tax attributable to the operating expenses of the business such as flight manuals and charts. The operating expenses directly attributable to the Aircraft are in dispute.

Interlaken would pay all bills relating to the operating expenses of the Aircraft and then pass the cost to petitioner by way of journal entries. No cash or other payment was transferred to Interlaken by petitioner. Although Interlaken considered the management fee owed by petitioner to be an item of revenue on its books, and petitioner treated it as an expense on its books, no funds moved between the two entities. In the area of Interlaken's purchases of fuel for the Aircraft, the purchase agreement with the supplier stated that the use of the Aircraft was noncommercial, and Interlaken paid the sales tax due on its purchases of fuel.

11. In the area of capital expenditures, the auditor determined additional taxable capital purchases of $25,165,819.00 and additional tax due of $1,855,979.26. The taxable capital expenditures consisted of the purchase of the Sikorsky helicopter and Falcon Jet as well as equipment installed on the Aircraft. In making the determination that petitioner was not operating as a commercial airline, the auditor reviewed the purchase contracts, trip logs and itineraries of the Aircraft during the first year of each aircraft's ownership and use for the purpose of determining the intent of the use of the Aircraft. The auditor found no evidence that the Aircraft were ever used for any outside charter. The only users of the Aircraft, for either business or personal use, other than maintenance and training flights, were the officers, directors, employees and family members of WRBC, with Mr. Berkley being the primary user. Petitioner charged WRBC for the hired use of the Aircraft for both purposes, and WRBC, in turn, reported amounts in wage and tax statements, federal forms W-2, with the Internal Revenue Service, using

applicable Standard Industry Fare Level mileage rates, when the Aircraft were used for personal transportation.

12. During the audit period, petitioner had a service contract with Interlaken to provide all services required to maintain, manage and operate on petitioner's behalf the Aircraft, including all related and accessory equipment. Petitioner was required under the Aircraft Management Service Contract to pay Interlaken for any and all costs and expenses of maintaining and operating the Aircraft. Interlaken had approximately 26 employees to perform the duties required under the service contract. At various times, Interlaken has entered into aircraft management service agreements with unrelated third parties that are similar to the service contract with petitioner. Interlaken applied petitioner's billings to WRBC for flights provided.

The director of operations for Interlaken was responsible for the hiring of all pilots and ancillary personnel. He was also responsible for approving all flights, including the availability of the Aircraft, the pilots to be used, suitable weather conditions, flight plans and flight durations. The director of maintenance of Interlaken was responsible for the supervision of all maintenance personnel. The Interlaken flight coordinator administered required scheduling and documentation and also provided dispatch services for the Aircraft.

13. On October 22, 2007, the Division issued to petitioner a Notice of Determination for the period March 1, 2003 through February 28, 2007, assessing sales and use tax due of $1,932,202.61, plus penalty and interest. On October 25, 2007, the Division issued to petitioners William R. Berkley, Eugene G. Ballard, Ira S. Lederman and Clement P. Patafio, as officers or responsible persons of petitioner WRBC Transportation, Inc., notices of determination for the same periods and in the same amounts.

SUMMARY OF THE PARTIES' POSITIONS

14. It is the Division's position that the Aircraft do not qualify as exempt commercial aircraft. The Division claims that the parent, WRBC, so dominated and controlled petitioner such that petitioner was an alter ego of the parent corporation, and therefore use of the Aircraft by the parent corporation, its officers, employees and their families constituted "self use" and not commercial use. In reaching this position, the Division points to the structure of ownership and operations of the corporations, the commonality of officers, directors and boards of directors of the related corporations, the lack of fixed costs and an allowance for profits in the charge for the use of the Aircraft and the method of compensation. The Division claims that the principle of substance over form should control in this matter, and that the form of the transactions involved herein is fundamentally incongruous with the substance of the transactions. In raising this argument for the first time in its brief the Division has explicitly abandoned the position it has presented throughout these proceedings that the concept of "piercing the corporate veil" should be applied in these matters.

15. Petitioner initially claims that the Aircraft meet the definition of commercial aircraft because they were used to transport the officers and employees of WRBC and its affiliated entities for hire. In response to the Division's position that the corporate structure should be ignored, petitioner points out that the evidence does not support the conclusion that WRBC completely dominated the conduct of petitioner in the operation of the aircraft or that WRBC did so in order to commit a fraud.

CONCLUSIONS OF LAW

A. Section 1115(a)(21) of the Tax Law provides an exemption from tax on retail sales and compensating use tax on commercial aircraft primarily engaged in intrastate, interstate or

foreign commerce, machinery or equipment to be installed on such aircraft and property used by or purchased for the use of such aircraft for maintenance and repairs and flight simulators purchased by commercial airlines. Maintenance services in connection with the use of a commercial aircraft qualify for exclusion from the imposition of sales tax under section 1105(c)(3)(v) of the Tax Law. Section 1101(b)(17) of the Tax Law defines a commercial aircraft as "[a]ircraft used primarily (i) to transport persons or property, for hire, (ii) by the purchaser of the aircraft primarily to transport such person's tangible personal property in the conduct of such person's business, or (iii) for both purposes."

B. The record establishes that the Aircraft meet the definition of "commercial aircraft" as that term is defined in Tax Law § 1101(b)(17). The Aircraft are used exclusively to transport personnel (or their family members) of WRBC. The flight activity schedules and related documents reviewed by the auditor established that all of the flights of the Aircraft were used by WRBC officials in connection with WRBC's insurance business or for their personal use. Petitioner charged WRBC for the hired use of the aircraft for both purposes, and WRBC, in turn, reported amounts in wage and tax statements, federal forms W-2, with the Internal Revenue Service, using applicable Standard Industry Fare Level mileage rates, when the Aircraft were used for personal transportation.

The arrangement among Interlaken, petitioner and WRBC establishes that adequate compensation was paid by WRBC for the use of the Aircraft to meet the requirement that the aircraft was used "to transport persons for hire." Interlaken would pay all bills relating to the operating expenses of the Aircraft, and then pass the cost to petitioner by way of journal entries. Interlaken treated the management fee owed by petitioner to be an item of revenue on its books, and petitioner treated it as an expense on its books. Charges for the use of the Aircraft were

considered revenue to petitioner and expenses to WRBC on their respective books and records. The charges were computed by multiplying the number of flight hours by a fixed rate. The fixed rate was determined on a yearly basis, and was based upon the variable costs of operating the Aircraft for the previous year. The fixed rate was computed by the accounting personnel of Interlaken. Revenue and expenses were reported by way of journal entries that were eliminated when the entities' federal returns were consolidated. As the requirements of Tax Law § 1101(b)(17) have been met, the purchase of the Aircraft, related machinery, equipment and other property, and related services are exempt from the sales and compensating use tax.

C. Having established that petitioner was entitled to the sales and use tax exemption set forth in Tax Law § 1115(a)(21), it is necessary to address the Division's contention that the WRBC so dominated and controlled petitioner that petitioner was the alter ego of the parent corporation, and therefore use of the aircraft by the parent corporation, its officers, employees and their families constituted "self use" and not commercial use. In raising this argument for the first time in its brief the Division has explicitly abandoned the position it has presented throughout these proceedings that the concept of "piercing the corporate veil" should be applied in these cases.

Although the Division has changed the name of the theory on which it relies in this matter, from the "piercing the corporate veil" theory to the "alter ego" theory, the substance of its position remains the same. In both theories, the Division has attempted to disregard the corporate form of the entities involved in order to impose a sales and use obligation on the purchase of the Aircraft by petitioner herein. The factors to be applied in each theory have been held to be indistinguishable, to not lead to different results, and to be properly treatable as interchangeable (***Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc.***, 933 F2d

131 [1991], citing Blumberg, The Law of Corporate Groups: Tort, Contract, and Other Common Law Problems in the Substantive Law of Parent and Subsidiary Corporations § 6.-03).

D. Generally speaking, the courts will disregard the corporate form whenever necessary to "prevent fraud or achieve equity" (***International Aircraft Trading Co. v. Manufacturers Trust Co.***, 297 NY 285 [1948]). The concept of piercing the corporate veil is a limitation on the principles that a corporation exists independently of its owners, as a separate legal entity and that the owners are not liable for the debts of the corporation (***Matter of Morris v. New York State Department of Taxation and Finance***, 82 NY2d 135, 603 NYS2d 807 [1993]; ***Bartle v. Home Owners Cooperative, Inc.***, 309 NY 103 [1955]; ***Rapid Transit Subway Const. Co. v. City of New York***, 259 NY 472 [1932]). This issue of piercing the corporate veil was examined in depth by the Court of Appeals in the ***Morris*** case, where it stated:

> The doctrine of piercing the corporate veil is typically employed by a third party seeking to go behind the corporate existence in order to circumvent the limited liability of the owners and to hold them liable for some underlying corporate obligation [citations omitted]. The concept is equitable in nature and assumes that the corporation itself is liable for the obligation sought to be imposed [citation omitted]. Thus, an attempt of a third party to pierce the corporate veil does not constitute a cause of action independent of that against the corporation; rather it is an assertion of facts and circumstances which will persuade the court to impose the corporate obligation on its owners . . . .
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> . . . Generally, however, piercing the corporate veil requires a showing that: 1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and 2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury [citations omitted].

(Morris, at 810; ***Lowendahl v. Baltimore & Ohio R.R***., 247 App Div 144 [1936], ***affd*** 272 NY 360 [1936]; ***see also Millennium Construction, LLC v. Loupolover,*** 44 AD3d 1016, 845 NYS2d 110 [2007].) The Court in ***Morris*** further stated that, in discussing the "alter ego" theory of disregarding the corporate form:

> In general, in matters relating to revenue a corporation will be recognized as having a separate taxable identity unless it is shown to have had no legitimate business purpose either in its formation or its subsequent existence or that it was a sham or set up for tax avoidance. (Citations omitted.)

The mere facts that the Aircraft were exclusively used by officers and family members of the parent corporation, the compensation paid by the parent corporation covered only the operating costs incurred with the use of the Aircraft and the purchase of the Aircraft was funded by the parent corporation do not, by themselves, require that the corporate form be disregarded. WRBC was not the cause of any fraudulent act or wrong perpetrated upon the Division. It is noteworthy that although the Division seems to allege that petitioner was formed for the purpose of tax avoidance, there exists no evidence in the record to support such a contention and the history of the company belies such a claim.

Petitioner was originally incorporated under the name Finevest Services Leasing Corporation for the general purpose of engaging in "any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware." Petitioner eventually purchased the helicopter and Falcon jet, which were registered under petitioner's name. The Aircraft were stored and operated out of the Westchester County Airport, in a hangar owned by Interlaken.

As for the operation of petitioner, it is noted that it has been in existence since 1983 and has owned various aircraft since 1996. Since 1996, and including the audit period, petitioner had a service contract with Interlaken to provide all services required to maintain, manage and operate on petitioner's behalf the Aircraft including all related and accessory equipment. Interlaken had approximately 26 employees to perform the duties required under the service contract. At various times, Interlaken has entered into aircraft management service agreements

with unrelated third parties that are similar to the service contract with petitioner. Interlaken performed petitioner's billings to WRBC for flights provided.

The director of operations for Interlaken was responsible for the hiring of all pilots and ancillary personnel. He was also responsible for approving all flights, including the availability of the Aircraft, the pilots to be used, suitable weather conditions, flight plans and flight durations. The director of maintenance of Interlaken was responsible for the supervision of all maintenance personnel. The Interlaken flight coordinator administered required scheduling and documentation and also provided dispatch services for the Aircraft.

While petitioner itself does not have a bank account, its contractual arrangement with Interlaken obviates the need for one. Interlaken made all payments of petitioner's Aircraft related expenses and invoiced and collected payments from WRBC for all flights taken by WRBC personnel on the Aircraft.

It appears that petitioner had a legitimate business purpose in its formation and carried on its business of owning and chartering the Aircraft thereafter. There is no showing that it was set up as a sham or for the purpose of tax avoidance (***Matter of Morris v. New York State Department of Taxation and Finance***; ***cf. Dannasch v. Bifulco***, 184 AD2d 415, 585 NYS2d 360 [1992] [where defendant appropriated assets for his own use, drained income from the corporation and conducted business in disregard of corporate formalities]). Finally, it is noted that the corporate structure herein makes sound business sense from the potential liability standpoint, particularly when dealing with aircraft that are used by corporate employees. As the Tax Appeals Tribunal stated in ***Matter of Rochester Amphibian Airways, Inc.*** (August 6, 2009), "the limitation of liability has been recognized by the courts as a 'perfectly legal' express purpose to incorporate." Therefore, the Division has not established the elements necessary to

either authorize piercing the corporate veil or hold that petitioner was the mere alter ego of WRBC.

Finally, it is noted that the Court of Appeals in ***Morris*** was clear in its holding that to hold an officer, shareholder or director liable by piercing the corporate veil for a liability the corporation does not owe is inconsistent with the essential theory of the doctrine, reasoning that pursuing the controlling shareholder under the doctrine presupposes that the corporation is liable. Therefore, since petitioner was not liable for the sales and use tax asserted, piercing the corporate veil is not warranted as a theory for pursuing WRBC.

E. This conclusion is consistent with the Division's position in a series of advisory opinions where it found corporate structures similar to that which exists herein appropriate, and that the corporate form of the entities involved in such arrangements should be recognized (***see e.g. Cleveland Browns Transportation LLC***, Advisory Opinion, March 6, 2006, TSB-A-06[8]S; ***IBM Credit Corporation***, Advisory Opinion, April4, 2003, TSB-A-03[17]S; ***Citiflight, Inc.***, Advisory Opinion, August 3, 2000, TSB-A-00[30]S).

F. Petitioners object to the Division's stating for the first time in its brief that it was abandoning its "piercing the corporate veil" theory on which it had relied and instead was adopting the "substance over form" or "alter ego" argument. Petitioners correctly note that section 3000.14 of the Tax Appeals Tribunal's Rules of Practice and Procedure requires both sides to file a hearing memorandum that provides a statement of the issues being contested and the legal authorities relied on. Pursuant to the regulation, an administrative law judge may preclude a witness's testimony or the introduction of documentary evidence upon a determination that a party has failed to make a good faith effort to comply with the requirements (20 NYCRR 3000.14[d]). Petitioners submit that the change in the Division's theory so late in

the hearing process establishes such a lack of good faith and requests that the notices of determination be canceled.

Initially it is noted that, as previously discussed, the factors to be applied in each theory are indistinguishable (***Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc.***), and, therefore, petitioners suffered no violation of their due process rights. Furthermore, even if it could be argued that petitioners were surprised or unable to respond in a meaningful manner to the later theory, the proper remedy in such a situation is not the cancellation of the statutory notices but being afforded the additional time necessary to make that response. In fact, petitioners requested and were granted a two-week extension to file their reply brief to the Division's brief. Since petitioners have never asserted a violation of their due process rights or the principles of fairness, including in their request for the two week extension, and the administrative law judge observed none, it is determined that none occurred (***Matter of Rochester Amphibian Airways, Inc.***).

G. Issue IV is rendered moot.

H. The petitions of WRBC Transportation, Inc., William R. Berkley, Eugene G. Ballard, Ira S. Lederman and Clement P. Patafio are granted, and the notices of determination dated October 22, 2007 and October 25, 2007 are canceled.

DATED: Troy, New York
September 16, 2010

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE