



## BUSINESS AVIATION AND THE BOARDROOM



Chris Younger is a partner at GKG Law, P.C. practicing in the firm's Business Aircraft Group. He focuses his legal practice on business aircraft transactions as well as issues relating to federal and state taxation and regulation of business aircraft ownership and operations. Mr. Younger can be contacted at [cyounger@gkglaw.com](mailto:cyounger@gkglaw.com)

# *Defensive Oversight: Part 2 - Preparing for federal tax challenges*

Similar in concept to the issues addressed last month regarding federal taxes, properly structuring the acquisition and operation of business aircraft is essential to successfully navigating a state tax audit, cautions attorney Chris Younger.

In Part 1 of this two-part series, I discussed defensive oversight in preparation for tax challenges by the Internal Revenue Service. In that article I stated "it is essential for companies that own and operate business aircraft to create a clear and unambiguous path that will lead a tax auditor to the simple conclusion that all tax consequences of such aircraft ownership and operation have been accurately addressed."

In connection with preparations for state tax challenges, I would modify this statement slightly to emphasize that a Board must always ensure that a

company also follows the clearest and least ambiguous path when complying with its state tax obligations, which differ from federal considerations. A state tax auditor, like his or her federal counterpart, must see that the proper path is followed.

### **INITIAL COMPLIANCE**

The primary state tax obligations faced by companies that own and operate business aircraft are sales and use taxes as well as personal property >





## What the Boardroom needs to know about Business Aviation



taxes. These taxes are typically applied in a highly formalistic manner, based on detailed state rules. Therefore, a Board must be apprised of the specific rules relating to the application of such taxes before an aircraft is acquired in each of the state(s) where such taxes could apply.

The Board must also understand the specific methodology that will be utilized for the elimination or minimization of such taxes, and the Board must ensure that the company meticulously follows all requirements associated with that methodology. A good example is the use of a "sale for resale" exemption from state sales and use taxes. Through the use of this exemption, many states permit an aircraft owner to defer its sales and use tax liability on an aircraft purchase.

The concept is fairly straightforward: a company forms a wholly-owned subsidiary company to acquire an aircraft and lease it back to the parent company. By using this structure, the aircraft purchase is exempt from sales and use tax. Instead, the subsequent rent payments are subject to the sales and use tax.

The difficulty in this example lies in following the precise path that is designed to ensure the successful implementation of the "sale for resale" exemption. Each state has its own specific requirements for the initial and continuing application of the exemption. For example, most states require that the purchaser be registered as a retailer or vendor (therefore eligible to collect sales or use tax) before it purchases the aircraft.

Additionally, the purchaser may be required to complete a Resale Certificate and deliver it to the seller at closing. The simple failure to ensure that a vendor registration is completed before the aircraft is purchased or to complete and deliver a resale certificate at closing can result in a denial of the application of the exemption in an audit.

### ONGOING COMPLIANCE

The Board must also ensure the company's ongoing compliance with the requirements of an exemption after the aircraft purchase. Using the "sale for resale"

exemption to illustrate my point, I have seen everything properly implemented at the outset of the aircraft purchase, only to be unwound several years later when an aircraft owner fails to follow the continuing requirements for the application of the exemption.

For example, an aircraft purchaser/lessor typically must invoice the affiliate/lessee for rent and actually collect such rent from the affiliate according to the terms of the lease agreement between them. If these seemingly innocuous steps are not followed, the application of the "sale for resale" exemption could be denied in an audit even if all sales tax on the rent amounts was reported and paid.

Such a failure, if not detected prior to an audit, can lead to catastrophic consequences such as the imposition of the full amount of sales tax as of the date that the rent was no longer paid, without a right to recover prior tax payments made with respect to prior rent payments. Obviously, such a result is worse than having paid the tax up front on the aircraft purchase.

As described above, the need for the Board to assemble a team of expert professionals and advisors to assist it with proper compliance oversight cannot be understated. Such a team can be an invaluable resource that enables a Board to proactively anticipate and oversee a review of state tax issues relating to the ownership and operation of a business aircraft.

**Note:** *This article should not be construed as legal advice or legal opinion on any specific facts or circumstances. The reader is urged to consult legal counsel or other advisors concerning his/her own situation and specific legal questions. Please be advised that, to ensure compliance with requirements imposed by the IRS, any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.*

Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: [Jack@avbuyer.com](mailto:Jack@avbuyer.com)

"I have seen everything properly implemented at the outset of the aircraft purchase, only to be unwound several years later when an aircraft owner fails to follow the continuing requirements for the application of the exemption".

