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Application of State Sales and Use Taxes to Business Aircraft Purchases and Operations

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Introduction

- Sales tax is imposed in the state where physical delivery of the aircraft occurs
- Use tax is imposed by the state(s) where the aircraft is "used and consumed" (i.e. hangared)
- Sales tax can easily be avoided, but use tax is harder to avoid
- Sales/use tax is generally a one time tax, not an annual tax

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Introduction

- Sales/use tax planning is primarily based on ownership structuring – form over substance
- Federal tax planning is substance over form
- Sales tax planning should be done first, as it provides the structural framework for the balance of the planning

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Introduction

- Although state law exemptions may be called by the same name, implementation varies significantly from state to state
- Timing and implementation mechanics generally must be strictly adhered to
- The tax rate for the use tax in any specific state will be identical to such state's sales tax rate
- Sales taxes and use taxes are mutually exclusive; States may impose a sales tax, or use tax, but not both on an aircraft purchase

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Concepts

<u>Sales Tax</u>

- Most states impose sales and use taxes between 2% and 10% on the purchase of tangible personal property (e.g. aircraft)
- Sales tax is a transaction-based tax and will apply only in the state where the transaction occurs (i.e. the aircraft delivery location)
- State sales tax jurisdiction is commonly referred to as *nexus*

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Concepts

Use Tax

- A state may impose a use tax on the use, storage, or consumption in the state, of property acquired outside the state and subsequently brought into the state

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Nexus

Use Tax

- Use tax nexus normally attaches to the locations where the aircraft is used, meaning where it is "based" or hangared
- An aircraft may have multiple "bases," and therefore nexus with more than one state
- Taxable aircraft use can also be on the first use within a state after title transfers; flight activity within a certain time period (e.g. six months); or the flight activity of the aircraft for a specified number of days
- The level of activity at which a state might assess a use tax varies (in some a single use will trigger, in other states it must be used within the state for a certain period of time)

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Nexus

<u>Use Tax</u>

- A state is unlikely to assess a use tax to a nonresident who operates the aircraft within the state only occasionally
- Rebutting a state law presumption can be difficult and the process for doing so varies from state to state
- Tools to rebut the applicability of state sales taxation include: (i) evidence of delivery outside the state, (ii) evidence of state sales tax paid to the state where the aircraft is primarily "based," and (iii) evidence of personal property tax paid to another state

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Planning Considerations

- If an aircraft will be based in a state that imposes use taxes, there may be no net tax advantage to taking delivery in a no-tax state
- State of incorporation/formation of the ownership entity will not create a tax advantage, but can create a disadvantage

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Specific Exemptions

- Fly away
- Occasional / casual sales
- Sales for resale
- Interstate commerce
- Common carrier

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Fly-Away Exemption

- Sales tax exemption for non-residents of the delivery location
- Time restrictions
- Re-entry can invalidate

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Occasional/Casual Sales Exemption

- Sales/Use tax exemption for used aircraft
- Generally focuses on details of the seller, not the buyer
- Differences among state requirements

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Sale for Resale Exemption

- Property is purchased solely for the purpose of resale
- Sales tax is then collected on the resale of the property unless otherwise exempt
- In many states a lease is considered a sale for sales and use tax purposes
- In states where leases are considered sales, a leasing structure may be created which allows for use tax to be paid on the rent from a stream of lease payments

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Sale for Resale - Qualifications

- In most states, the aircraft owner/lessor must be registered as a resale vendor with the state's taxing authority at the time of purchase
- The aircraft owner/lessor generally must be a party to a "dry" lease effective on the date of purchase

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Sale for Resale Exemption

- The payment of use tax on the flight activity instead of on the aircraft purchase normally results in significant overall tax savings over the short term

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Sale for Resale Exemption - Pitfalls

- Some states have acceleration clauses on leases (the requirement that sales/use tax must be paid on the entire lease term upfront)
- To avoid problems with related party leases, confirm that the lessor has a profit motive by implementing leases with ordinary (arm's-length) commercial terms

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Sale for Resale Exemption - Pitfalls

- It is vital that all lease payments be made on time, and that all other lease formalities be followed
- Any inconsistent use other than holding for resale can cause the exemption to not be respected and have sales tax due on the full purchase price of the aircraft

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Interstate Commerce Exemption

- Interstate commerce exemptions may apply to both FAR Part 91 and 135 on-demand use
- Generally requires use of aircraft, crossing state lines (i.e. interstate flying) in furtherance of business/commercial activities

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Common Carrier Exemption

- Generally requires aircraft to be owned or used by an FAA licensed carrier
- Some states limit the exemption to scheduled carriers while other states will also include on-demand carriers

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State Sales Tax Credits

- Generally, one state will give a credit for sales or use tax “properly paid” first to another state
  - Exception: Aircraft Dry Leases

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Like-Kind Exchange vs. Trade-in Credit

- Often confused as synonymous
- Sales and use taxes are state taxes, while a like-kind exchange relates to Federal income tax
- Trade-in credit is that portion of the purchase price “paid” with the trade-in property rather than in cash
- Both may be utilized in the same transaction

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Fractional Shares

- Generally, fractional programs will deliver aircraft in a state with an applicable sales tax exemption/cap
- Use tax statutes in state where fractional owner is a "citizen" for state income tax purposes must be examined
- Most states do not have specific rules regarding application of sales and use taxes to fractional shares but some do

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Fractional Shares

- When no specific guidance exists on application of sales and use taxes to fractional shares, then default to general rules for whole aircraft
- If use tax rules (nexus) do not specifically require "basing" aircraft in such state, then use tax risk is present
- Risk increases if no sales or use tax paid anywhere (caveat: sales tax paid to Ohio generally not relevant)
- Consider planning to meet an exemption, such as "sale for resale"

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Florida Update: 6 Month Rule For Florida Residents

- In Florida, if within the first six months after the purchase of an aircraft it:
  - (1) is not brought into Florida for more than a minimal amount of time;
  - (2) is not subject to a lease structure;
  - (3) is subject to another jurisdictions' taxing authority and any tax lawfully due in that jurisdiction is paid; and
  - (4) is titled or registered in such other jurisdiction (while the statute does not explicitly require this, previous discussions with the Florida Department of Revenue has found that they may take an informal position that an aircraft be titled or registered in another jurisdiction to show it was intended the aircraft was purchased for use outside of Florida);
- It is presumed that the aircraft was purchased for use outside of Florida.

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Florida Update: 6 Month Rule For Florida Non-Residents

- Effective as of July 1, 2010.
- Aircraft can enter Florida for up to 21 days for any purpose, or for an unlimited amount of time within this six-month period for the exclusive purpose of flight training, repairs, retrofitting, or modification—without being subject to any use tax.

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Interstate Commerce Exemption - California

- California has both an Interstate Commerce Exemption (Regulation 1620) and a Common Carrier Exemption (Regulation 1593)
- The requirements for the Interstate Commerce Exemption include:
  - (i) must acquire the aircraft outside of California
  - (i) the first functional use of the aircraft (i.e. a interstate or international business or commercial flight) must be outside of California
  - (iii) use the aircraft in interstate or foreign commerce more than one-half of the flight hours during the 6 month period immediately following first entry into California

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Common Carrier Exemption - California

- The Common Carrier Exemption requires that an aircraft be used as a common carrier for more than 50% of its flight hours during the 12 month period commencing with the first flight of the aircraft

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California Exemption Comparison

- The Interstate Commerce Exemption is preferred due to the shorter test period (6 months versus 12 months)
- The level of documentation necessary to substantiate compliance with the requirements of the Interstate Commerce exemption is significantly less than that required for the Common Carrier Exemption

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Sales and Use Tax – Various State Provisions

- Alaska, Delaware, New Hampshire, Montana and Oregon - no sales tax (beware personal property tax)
- Connecticut – exempts aircraft having a maximum gross takeoff weight in excess of 6,000 pounds
- Massachusetts and Rhode Island statutory aircraft sales and use tax exemption
- Illinois – Rolling Stock Exemption
- North Carolina and South Carolina have very low sales tax caps for aircraft
- Virginia imposes taxes on aircraft at lower rates (2%) than other types of assets, but there are few exemptions
- Maryland Interstate Commerce Exemption for both FAR Part 91 and 135 (12 month test)

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