

## STATE SALES AND USE TAXES: EARLY PLANNING IS A MUST

By: Rex E. Reese

Let's say you are about to take delivery of a new Global Express. You have paid in \$10 million in equity, and your lender will pay the remaining \$35 million or so. Your CFO and Board of Directors have approved the purchase price plus the annual operating costs. The aircraft purchase agreement calls for a closing in a particular state, and your pilots are already on their way to the agreed delivery location to take delivery and to fly the aircraft to your home operating base. Your entire Executive Committee are scheduled to fly to Hong Kong the day after tomorrow for an important meeting.

Then someone somewhere, maybe your outside accountant, or your corporate attorney, asks you: "how do you plan to avoid sales and use taxes on the aircraft." Oops! You panic, and justifiably so. Your mind races. "What is this tax?" "How much is it?" "When is it due?" "Who pays it?" "Can we avoid it?" "Must we delay the closing until we can get this sorted out?" "Who was supposed to be worrying about this before now?!!!"

As counsel to hundreds of new and used aircraft transactions every year, it is our policy to raise the Sales and Use Tax question during the initial discussion of the deal. Quite often, however, we get called into a transaction not long before the closing, at which point our Sales and Use Tax advice may call for some significant restructuring of the closing and/or the long-term operations of the aircraft.

All but a handful of the 50 American states have some form of regime for taxing tangible personal property. Although a few states employ a “Personal Property Tax,” most employ a “Sales and Use Tax.” Because of their cost, aircraft are a juicy target for Sales and Use Taxes and Personal Property Taxes, many of which are calculated as a percentage of fair market value.

Depending upon the state, the tax burden can be anywhere from a few thousand dollars to up to 10% of the aircraft’s purchase price. In the case of the subject Global Express, this could mean a \$4.5 million tax, which for most CFOs and Boards of Directors translates into a deal killer, and worse for the party who was supposed to be worrying about this issue.

By the design of most states’ statutes, the Sales Tax and the Use Tax are complementary taxes; their rates are the same and only one of them applies to a particular transaction. Sales Tax applies where the passage of title occurs in the case of a purchase, and where possession is conveyed in the case of a lease. Use Tax applies where the property is used, stored or consumed. Once a state’s Sales Tax has been incurred, its Use Tax normally does not apply. However, where the sale occurs in one state, but the property is to be used in another state, an analysis must be undertaken to determine, among other items, whether both taxes could apply and, if so, whether one state gives a credit for the tax paid in another.

Fortunately, many states provide exemptions from Sales and Use Tax. Common examples of exemptions include the “fly-away” exemption, the “sale for resale” exemption, the “casual or occasional sale” exemption, the “air carrier” exemption, the “rolling stock” exemption, among others. One can normally surmise the substance of these exemptions by their description titles; however, they are structured differently from state to state and are often not so clearly, as above, identified in the statutes, regulations and other authorities.

In the case of a party’s sale of one aircraft and immediate acquisition of another, some states provide a “trade-in credit,” which effectively reduces the taxable value of the new aircraft by the value of the old one. And some states expressly recognize that mobile property like aircraft are used in several states and, owing to certain U.S. Constitutional principles, have instituted apportionment of value based on relative use among the relevant states.

Whether it is to qualify for an exemption, apportionment or a credit, many states impose form-filing and other reporting burdens on one or both parties to the transaction. Very often, the failure to comply with administrative procedures prior to the closing of the transaction will result in the total loss of the tax savings opportunity.

In conclusion, Sales and Use Tax can be expensive if not planned around, and there are many potential tax-savings measures that an experienced aviation tax adviser can identify. So you don’t find yourself saying “Oops!,” at the wrong time, make sure

that someone is worrying about Sales and Use Taxes early in the process of structuring and papering a deal.