Sales and Use Taxes for Pilots:

An Aircraft Acquisitions Primer for Pilots and Aircraft Buyers

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It has often been said that only two things in life are certain; the first is death, and the second is taxes. As all conscientious, professional pilots know, knowledge and advance planning are keys to postponing the first of life's certainties as long as possible. Only by having a thorough understanding of aerodynamics, aircraft systems, navigation and weather, and by employing such knowledge to plan every detail of a flight, may a pilot best ensure the safety of his or her aircraft and passengers. Similarly, knowledge and advance planning are keys to minimizing sales and use taxes associated with aircraft acquisitions and operations. Only by having a thorough understanding of state sales and use taxes applicable to aircraft acquisitions and operations, and by employing such knowledge to plan every detail of an aircraft acquisition and operating structure may an aircraft buyer best ensure the safety of his or her finances against claims by the tax collector.

Due to the number and complexity of sales and use tax issues that must be considered in planning for aircraft acquisitions and operations, as well as the tremendous variations in sales and use tax laws from state-to-state, it is not possible to discuss all applicable issues in this article. Rather, this article will highlight a variety of the sales and use tax concepts most often encountered in aircraft acquisitions and operations.

Sales Taxes.

Contrary to popular belief, the term "sales and use taxes" does not refer to a single type of tax, but rather to two separate, albeit inter-related types of taxes, *i.e.*, "sales taxes" and "use taxes". Planning to avoid or minimize sales taxes is actually a relatively simple matter. This is because Constitutional and jurisdictional limitations prevent any state from imposing a sales tax on a transaction that occurs outside its own borders. Consequently, exclusive jurisdiction to impose a sales tax on an aircraft transaction belongs to the state where the aircraft is physically located when title and/or possession is transferred from the seller to the buyer. A few states, however, either do not impose a general sales tax at all (*e.g.*, Montana, Oregon, New Hampshire), or exempt certain aircraft from all or a portion of an otherwise generally applicable sales tax (*e.g.*, Connecticut exempts all aircraft having a maximum certified takeoff weight of 6,000 lbs or more). Furthermore, some states that do impose sales taxes on aircraft provide a so-called "fly-away" exemption that exempts the purchase of an aircraft by a non-resident of the state from sales tax if the aircraft is subsequently removed from the state within a specified period of time (*e.g.*, Kansas exempts aircraft removed from the state within ten (10) days of purchase).

The fact that some states do not impose sales taxes, or exempt certain aircraft from their sales tax coverage, provides buyers ample opportunity to avoid sales taxes on the acquisition of an aircraft. The buyer generally must only ensure that the aircraft is physically located within such a state at the time title and/or possession is of the aircraft is received. The buyer should also obtain records establishing the location of the aircraft at the time of title and/or possession transfer. These records may come in handy in the event of a sales and use tax audit. Records

commonly obtained for this purpose include fuel receipts, aircraft delivery receipts, and logbook entries. Such records should contain the identification of the aircraft, the name and location of the airport or FBO where the transfer occurred, and a date and time entry that coincides with the transfer of title and/or possession.

Use Taxes.

While planning to avoid or minimize sales taxes may be a relatively simple matter, determining whether an exemption from sales tax is available with respect to the initial acquisition of an aircraft is seldom the end of the sales and use tax planning process. Rather, an aircraft buyer also must be concerned with the potential application of a use tax in any state where the aircraft will be operated.

Use taxes were originally devised by states to deter avoidance of sales taxes and to enable states to recapture sales tax losses that occur when a resident of the state purchases property in another state that either does not impose a sales tax, or imposes a sales tax at a lower rate, and subsequently returns with the property to the state of residence. Because the state of the buyer's residence does not have jurisdiction to tax the resident's out-of-state purchases, use taxes typically do not apply to purchases of property *per se*, but rather to the use, consumption, and/or storage of property within the state.

Use taxes are often referred to as being "complimentary" to sales taxes. This means that a buyer of taxable property generally is required to pay one or the other of the taxes, but not both, and that in any given state, the use tax rate and the sales tax rate will likely be identical. Thus if an

aircraft buyer who intends to base and operate an aircraft in state X successfully avoids a sales tax in state X by purchasing the aircraft in another state which does not impose sales taxes, the buyer will likely be required to pay a use tax in State X, and the amount of the use tax will be the same amount the buyer would have paid as sales tax had the purchase of the Aircraft occurred in State X. Conversely, if the same buyer purchases the aircraft in state X and pays sales tax in state X, the buyer should not also be obligated to pay use tax in state X.

In some states, an aircraft may become subject to use taxation only if it is present in the state for a specific number of days. In most states, however, no such bright line test exists, and an aircraft could, theoretically, become subject to use taxation the first time the aircraft is used in the state, unless some statutory or constitutional basis for exclusion or exemption is available. As a practical matter, however, it is unusual (though not unheard of) for a state other than the state in which an aircraft is primarily used and hangared to assert a use tax unless the aircraft is within the state for a substantial period of time during a particular year.

Credits and Exemptions.

Even if an aircraft will be purchased, based, and primarily operated in a state which imposes sales and use taxes, it may be possible, with proper planning, to reduce or eliminate sales taxes by structuring aircraft purchases and operations so as to take advantage of whatever credits or exemptions may be available. Virtually every state that imposes sales and use taxes provides certain kinds of credits and/or exemptions from their sales and use taxes. However, the types of credits and exemptions, and the conditions under which an aircraft buyer may qualify for a credit or exemption, vary greatly from state to state. Consequently, the credits and exemptions

available in one state may not be available in all states. Further, an aircraft buyer who qualifies for an exemption in one state may not qualify for a similar type of exemption in another state. Some of the more common types of credits and exemptions include the following:

Trade-In Credits.

Anyone who has ever traded-in an automobile at a car dealership in a sales tax state is probably familiar with the concept of the trade-in credit. In many states, when a person trades one item of property, be it a car or an aircraft or some other type of tangible personal property, as partial payment for another item of property, it is only the excess of the purchase price of the new item over the value of the trade-in property that is subject to tax. Thus, if a person purchases a $10,000,000 aircraft in a state with a 5% sales tax, the sales tax on the transaction would be $500,000. However, if the same individual trades-in another aircraft with a value of $4,000,000 and pays the $6,000,000 difference in cash, only the $6,000,000 cash payment would be subject to tax, and the sales tax on the transaction would be $300,000.

The rules for qualifying for a trade-in credit vary from state to state. In most states, one must trade-in property to a licensed dealer in order to qualify for a trade-in credit; exchanges between private parties may or may not qualify. Similarly, where an aircraft owner sells an aircraft to one person, and purchases another aircraft from another person, the transaction likely might not qualify for a trade-in credit, even if the two transactions were structured as part of a 1031 tax-free exchange using a qualified intermediary or a qualified exchange accommodation titleholder.

Further, in some states, one may trade any item of tangible personal property for any other item of tangible personal property. In other states, properties must be of like-kind. Where like-kind rules do not apply, a person may qualify for a trade-in credit by trading a $1,000,000 yacht plus $2,000,000 for a $3,000,000 aircraft, and pay sales tax on only the $2,000,000 difference. Conversely, in states where like-kind rules do apply, a person who trades in a $1,000,000 yacht and pays $2,000,000 additional cash for a $3,000,000 aircraft would not be entitled to a trade-in credit and would therefore pay sales tax on the entire $3,000,000 price of the aircraft, whereas another person in the same state who trades in a $1,000,000 aircraft and pays $2,000,000 additional cash for a $3,000,000 aircraft would be entitled to a trade-in credit and would pay sales tax on only the $2,000,000 difference.

Sale-for-Resale Exemptions.

The sale-for-resale exemption is among the most widely used exemptions in corporate aircraft transactions. Virtually every state that imposes sales and use taxes imposes such taxes only on retail sales; wholesale transactions are not taxed. By taxing only retail transactions, the law avoids imposing a tax at each stage of the product distribution chain, and causes the tax to be borne only by the final end user of a product.

The sale-for-resale exemption is important to corporate aviation for at least two reasons. First, it allows aircraft brokers/dealers to acquire inventory aircraft tax-free. Second, in some states where lease and rental payments are subject to sales taxes, an aircraft buyer may be permitted to avoid paying sales tax up front on the original purchase price of the aircraft by forming a leasing company to take title to the aircraft, and then leasing the aircraft to another entity that will

operate the aircraft. Where such a structure is employed, sales taxes may be due and payable only on the rent payments received each month.

Although sales tax still must be paid in the leasing context, such an approach permits the tax to be spread out and paid over a number of years rather than in one lump sum. Further, in the event the aircraft is retained for only a few years, the total amount of sales tax paid over time may be less that had the tax been paid up front. Of course, if the aircraft is leased out for a longer period of time, the total amount of tax paid over time can also exceed the tax that would have been paid had the tax been paid up front. A break-even point analysis will be necessary to determine whether a leasing structure makes sense. If it is relatively certain that an aircraft will be owned for a period of time exceeding the break-even point, a sale-for-resale structure may not be appropriate. However, if an aircraft buyer expects to trade up to a larger or newer aircraft within a few years, or otherwise intends to own a particular aircraft for only a few years, a sale-for-resale structure can save tens of thousand of dollars or more in taxes.

Common Carrier/Interstate Commerce Exemptions.

Most states provide some form of common carrier or interstate commerce exemption. However, the requirements to qualify for these types of exemptions vary from state to state perhaps to an even greater degree that any other type of exemption. For example, some states exempt only certificated air carriers who use their aircraft exclusively for scheduled FAR Part 121 operations, while some other states also exempt aircraft used by Part 135 operators exclusively or predominantly (*i.e.*, more than 50% of the time) in on-demand charter operations, while yet

other, more lenient states do not require any form of FAA certificate, and exempt any aircraft that is used predominantly for interstate business-related transportation.

Occasional or Isolated Sale Exemptions.

Almost all states have some form of statute that exempts casual, occasional or isolated transactions where the seller is not actually in the business of selling tangible personal property at retail. These types of exemptions are of limited utility to most aircraft purchasers, however, because in most state the exemption is limited to transactions involving small dollar amounts (*i.e.*, $100 or less), or is not applicable to certain types of property (*i.e.*, aircraft, boats, motor vehicles, etc.). In those few states where no such limitations or restrictions exist, buyers who purchase aircraft from persons or companies other than aircraft brokers/dealers can realize substantial tax savings.

Conclusion.

Among the first tax planning tasks accomplished by any first-time aircraft buyer should be to structure the acquisition and operations of the aircraft in a manner that will minimize or eliminate sales and use taxes. Such planning is critical in light of the fact that sales and use taxes on multi-million dollar aircraft can easily climb into the hundreds of thousands, if not millions, of dollars. Sales and use tax planning is not, however, a task for the feint of heart. The laws and regulations are highly complex and differ greatly from state-to-state. The information provided in this article is general in nature and should not be relied upon in planning for an aircraft acquisition. Readers are encouraged to consult their own tax advisors before implementing any sales and use tax planning strategy.

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