MINIMIZING SALES TAX EXPOSURE IN AIRCRAFT ACQUISITIONS - AN EVER MORE DIFFICULT ENDEAVOR.

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As we described in our series of "Mission Possible" articles, which World Aircraft Sales magazine published in its recent editions, one of the primary considerations when structuring the acquisition of a business aircraft is potential state sales and use tax liabilities. Although most deliveries of new and used aircraft occur in states with either no sales tax or an applicable fly away exemption, resulting in no sales tax being collected by the seller at closing time, the subsequent hangaring of the aircraft in the purchaser's home state will cause a use tax to become due to such home state. The use tax is equal to the sales tax as if the transaction had actually closed in the home state. On a large cabin class aircraft, this liability could in many cases exceed $3,000,000. The good news is that, many times, if properly structured, this liability can be avoided. The bad news is that, very often, aircraft owners do not seek proper advice from knowledgeable aviation tax professionals and unknowingly have this liability. This article will help identify good and bad planning considerations.

Many states, faced with increasingly large budget shortfalls and decreasing sources of new tax revenue, are more thoroughly and carefully scrutinizing aircraft physically located in their state to determine if they are owed a sales or use tax on such aircraft. Currently, California will send out notification to all aircraft owners requiring supporting documentation for any claimed exemption. In Indiana, it is now routine for the state to issue to the owner a proposed tax assessment, despite the fact that such owner has correctly followed Indiana's procedure for establishing an exemption from its sales and use tax on the basis of using a "sale for resale" structure.

Based on recently issued Indiana Department of Revenue rulings on the issue, it appears that aircraft dry leases between related parties will always be treated as "sham" transactions to which the sale for resale exemption from Indiana sales and use tax is now almost automatically denied. Indiana, like all states, looks for evidence of an "arm's-length" transaction between the lessor and the lessee. In related party transactions, where a special purpose entity has been created to own the aircraft, and lease it to the related operating companies, good planning techniques would include such things as having a written executed lease agreement (with all blanks filled in), having a "fair market value" rent reflected in the lease, and actually

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having the lessee pay the rent to the lessor, even though both companies are owned by the same person.

There is now a growing trend all across the country for states to make compliance with these strategies administratively difficult, overly time consuming, and confusing. States often insist that, to qualify for a particular exemption from sales or use tax, a taxpayer must follow precisely each intricate step involved in such compliance in exactly a particular order. For example, in Florida and New York, this may involve having certain items, such as dry leases or retail sales registrations, in place prior to the acquisition of the property in question. It may also involve a requirement by the state that applicable sales tax exemption forms be filed within a certain time period prior to or following the acquisition or in a certain specific number or with numerous agencies within the state bureaucracy. In many instances, it is impossible or nearly impossible to know what a state requires without having previously encountered and engaged in the process designed by those states.

Setting up an internal dry lease between related parties (i.e. a sale for resale transaction) is now a very common planning technique. However, there are numerous "gotchas." For example, in Florida, the state law provides that sales tax is calculated in the rental payment amount, and cannot be "included" in the rental payment. In New Jersey, as in many other states, sales tax is calculated on an "accelerated" basis, meaning that the tax is due at the time of lease signing and is calculated on all the rent that will accrue during the lease term. Other states distinguish whether liability accrues under a lease on the basis of whether the closing occurred inside or outside of their state borders.

Naturally, all of this reinforces the need for thorough tax planning *prior to* the purchase of an aircraft. A purchaser of a business aircraft should consult well known experts in the area of aviation sales and use tax planning; not the purchaser's local CPA or tax attorney, but instead someone who regularly handles aircraft transactions. Avoid cavalier planning, planning that is not based on a specific statutory exemption or procedural structure or planning that is based on something done on your prior aircraft purchase, as laws often change. Most importantly, avoid planning based on "cocktail party" talk where you hear that "everyone is doing it this way or that way."

Having planned sales and use tax strategies for thousands of these transactions, the team of business aviation attorneys at Galland, Kharasch, Greenberg, Fellman & Swirsky are fully versed in the intricacies of state sales and use tax planning. The result is a properly planned and implemented strategy that is devised to reduce or eliminate sales and use tax exposure within a particular state to the fullest extent possible within the context of the state's law.

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