Aviation Tax Law Webinar – October 24, 2017

New Developments in State Sales and Use Taxes on Aircraft Purchases Key Sales and Use Tax Planning Tools



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Disclaimer

This presentation is being provided for general information and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult your attorney or other advisor concerning your own situation and for any specific legal question you may have.





Upcoming Webinar

→ Tuesday, November 14, 2017 - Troy Rolf, Partner, GKG Law, P.C., will give a Webinar entitled "Bonus Depreciation Update / Tax-Free Aircraft Exchanges Under Code Section 1031". For more information and to register, please go to www.gkglaw.com.





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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" or stored (i.e. hangared)
- → Sales tax can easily be avoided, but use tax is more difficult to avoid
- → Sales/use tax is generally a one time tax, not an annual tax (cf. personal property taxes/annual registration fees)





Introduction

- → Sales/use tax planning is primarily based on ownership structuring – form over substance
- > Federal tax planning typically relies on substance over form
- → Some states now analyze planning structures based on substance over form
- → Sales tax planning should be performed first, as it provides the structural foundation for the balance of the tax planning and FAA/DOT compliance





Introduction

- → Although state law exemptions may be referred to by the same name, their 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 typically 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.





Concepts

Sales Tax

- → Most states impose sales/use tax generally 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





Concepts

Use Tax

→ A state may impose a <u>use tax</u> on the use, storage, or consumption in the state, of property acquired outside the state and subsequently brought into the state.





Nexus

Use Tax

- → Use tax nexus normally attaches to the locations where the aircraft is used, meaning where it is "based" or regularly hangared.
- → An aircraft may have multiple "bases," and therefore nexus with multiple states.
- → 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).





Nexus

- → A state is unlikely to assess a use tax on a nonresident who operates an 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 application of state sales or use tax to an aircraft 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.





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 state that does not impose its sales tax on aircraft.
- → State of incorporation/formation of the ownership entity will not create a tax advantage, but can create a disadvantage.
- → Carefully consider address used on FAA aircraft registration form.





Specific Exemptions

- → Fly away
- → Occasional / isolated / casual sales
- → Sales for resale
- → Interstate commerce
- → Common carrier / commercial operator





Fly Away Exemption

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





Occasional/Casual Sales Exemption

- → Sales/Use tax exemption for used aircraft
- → Focus in most states is on details of the seller, not the buyer
- → Differences among state requirements





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.





Sale for Resale - Qualifications

- → In most states, the aircraft owner/lessor must be qualified to transact business in the state and 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.





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, the lessor must have a profit motive by implementing leases with ordinary (arm's-length) commercial terms including rent rate/amount
- → Look out for state-specific restrictions on related party leasing structures





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





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





Interstate Commerce Exemption

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





Common/Commercial Carrier Exemption

- → Generally requires aircraft to be owned or used by an FAA licensed air carrier
- → Some states limit the exemption to scheduled carriers while other states will also include on-demand carriers
- → Some states restrict application where use is by parties that are related or affiliated with owner





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 and tax on rent paid thereunder





Like-Kind Exchange v. 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 but implementation is complex





Fractional Shares

- → Generally, fractional programs will deliver a fractional interest in an aircraft when the aircraft is located 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
- → Some states have specific rules regarding application of sales and use taxes to fractional shares





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"





Recent Developments

- → Arkansas: Broadened the application of its fly-away exemption.
- Arizona: New common carrier exemption effective July 1, 2017.
- → New York: New sales tax exemption for general aviation aircraft and parts installed thereon effective September 1, 2015.
- → North Carolina: Sales tax rate on aircraft raised to 4.75% with an increased maximum of \$2,500.
- Texas: Statute enacted effective September 1, 2015 containing provisions clarifying sale for resale/leasing structure requirements and parameters.
- → South Carolina: Maximum sales tax is \$500 effective July 1, 2017.
- → Tennessee: Lengthened removal time for fly-away exemption to 30 days; Added parts & labor exemption for large aircraft.





Florida : Six Month Rule For Florida Non-Residents

- → General requirements for six month rule apply.
- Aircraft can enter Florida for up to 20 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
- > Does not work with leased aircraft using sale for resale exemption





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





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





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





Sales and Use Tax – Various State Provisions

- Alaska, Delaware, New Hampshire, Montana and Oregon no sales tax (beware of personal property tax and registration fees)(Alaska has local sales tax in some locations)
- → Connecticut exempts aircraft having a maximum gross takeoff weight in excess of 6,000 pounds
- → Maine, Massachusetts, New York and Rhode Island have broad aircraft sales and use tax exemptions
- Illinois Rolling stock exemption is only viable sales and use tax planning tool
- → 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)





Closing Remarks

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