Overview of State Sales Tax Considerations In Aircraft Purchase Transactions

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I. Overview of State Sales and Use Tax

Most states impose a sales and use taxes of between 3% and 10% on aircraft purchase transactions, but there are exceptions. 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. In other words, with respect to any individual item of property, a state generally will assess either a sales tax or a use tax, but not both. In order to determine the applicability of a state's sales or use tax provisions, an understanding of the following concepts is essential.

A. Sales Tax

A state may impose a sales tax on the purchase or lease of property within the state in the absence of an applicable exemption. The sales tax is a transaction-based tax and will apply only in the state where the transaction occurs (i.e., the aircraft delivery location). The place where lease transactions occur may be the place where the aircraft is delivered at the beginning of the lease, the hangar location of the aircraft, or any other state that has jurisdiction to tax the aircraft. State sales tax jurisdiction is commonly referred to as nexus.

B. 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. Whether a use tax will apply depends on the structure of the state's use tax provisions. Some states impose a use tax on the first use of property in the state, other states impose the use tax only on property used in the state within a certain time period after it was purchased (e.g., six months), and some states impose the use tax upon presence of the property in the state for a specified number of days (e.g., 30, 60, etc.). Domicile of the property owner may be a key factor in some states, and irrelevant in others. Many variations are possible.

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Due to the mobility of aircraft, they may be used, and, therefore, technically subject to use taxation, in any state where the aircraft has nexus. As a practical matter, however, it is unlikely that any state, regardless of its use tax structure, will attempt to assess a use tax against an aircraft owned by a nonresident who operates the aircraft in the state only occasionally. An aircraft owner or prospective aircraft purchaser should become familiar with the use tax provisions of the state where the aircraft will be hangared and primarily based, his or her own domicile, or if the owner is a business entity, the state(s) in which it has its principal place of business, and any other state where the aircraft may be used on a frequent basis.

II. Planning Considerations

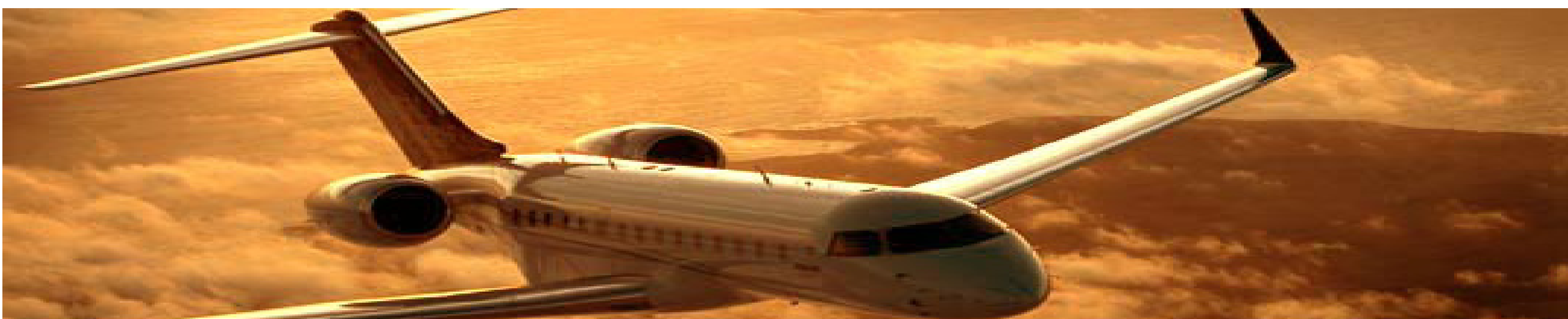
In most cases, an aircraft will be subject to a use tax in the state in which it is permanently based and hangared (assuming the state imposes sales and use taxes on aircraft). When a taxpayer intends to hangar and permanently base an aircraft in a state that imposes sales and use taxes, there is seldom any real net tax advantage to taking delivery of the aircraft in another state in an attempt to avoid paying a sales tax; although the taxpayer may successfully avoid a sales tax liability in the state where the aircraft will be hangared and permanently based, the taxpayer will in all likelihood incur an equivalent use tax liability upon relocating the aircraft to the state where it will be hangared and permanently based.

Buyers should, in all cases, avoid purchasing an aircraft in a state with a sales tax rate higher than the use tax rate in the state where the aircraft will be hangared and permanently based (unless the purchase would be subject to an exemption from the sales tax). In such a case, the credit against the use tax in the state where the aircraft will be hangared and permanently based would offset the entire amount of the use tax; however as the credit is "nonrefundable" in every state, the amount of sales tax paid on the acquisition of the aircraft in excess of the amount of the use tax imposed in the state where the aircraft will be hangared and permanently based may not be recovered or used to offset any other tax.

III. Exemptions to Sales and Use Taxes Applicable to Aircraft

A. Isolated or Occasional Sales Exemptions

Several types of exemptions may be available to permit the purchaser of an aircraft to purchase or use an aircraft tax-free. In some states, an "isolated sales" or "occasional sales" exemption exempts from taxation the purchase of property from a person who is not in the business of selling. Often, however, states specifically carve out big ticket items that are sold infrequently from the exemption. Inasmuch as the casual sale exemption must be relied on in some states to exempt mergers, and formation and distribution transactions, it is important to consider whether the transfer of aircraft in connection with these transactions is truly tax exempt.



B. The Sale-for-Resale Exemption

The most significant exemption to sales and use tax as it relates to aircraft is the "sale-for-resale" exemption. The exemption is based on two concepts. First, sales taxes generally apply to retail sales only, not to wholesale sales, and second, leases are generally considered taxable sales. In many states, these two concepts permit an individual or a company to establish a separate business entity as a "Holding and Leasing Company" to purchase an aircraft tax-free if its sole use of the aircraft will be to hold it for lease to other parties at arm's length. The individual or company may then lease the aircraft from the entity that owns the aircraft. In such a case the lease payments would be subject to sales tax. The use of such a structure therefore results in tax-deferral, and ultimately the total tax that will be paid depends on the number of years that the aircraft is owned. In other words, the tax advantage comes from the ability to pay tax on the lease payments annually over several years rather than the entire sum up front. Present value calculations would likely suggest that it would take anywhere from ten to fifteen years to pay the same amount of tax as if it had been paid up front.

The Federal Aviation Regulations prohibit a Holding and Leasing Company as described above from leasing the aircraft "with crew" (sometimes referred to as a "Wet Lease") to third parties. Such a company may only lease the aircraft itself, and may not provide aircraft management and pilot services (a "Dry Lease"). Consequently, the person or company to whom the aircraft is leased must separately acquire crew by hiring them as employees, setting up a pilot company, or by entering into an agreement with an independent management company (other than the Holding and Leasing Company). The Holding and Leasing Company's only function will be to secure the benefit of the sale for resale exemption.

Frequently, states will try to distinguish between capital leases and operating leases in some fashion. A lease with an option to purchase for a nominal sum is often viewed as the equivalent of a sale, and tax is due on the original purchase price. Less frequently, states will have a lower threshhold for identifying a capital lease, such as Virginia, for example, where leases that total more than 80 percent of the value of the aircraft are treated as taxable sales.

Another strategy that states use to frustrate the effective use of the sale for resale exemption, as it applies to capital equipment, is to require the lessee or the lessor to pay tax on the total of all lease payments due under the lease as of the commencement date. In some cases, this results in a higher tax than a tax on the sale. Still other states will not tax leases at all. This prevents the use of the sale for resale exemption, because the exemption depends on the existence of at least two taxable transactions: the purchase and the release. If the second transaction, the lease, is not taxable, the first transaction is not a purchase for resale, and tax is due on the original purchase price.

C. The Trade-In Credit

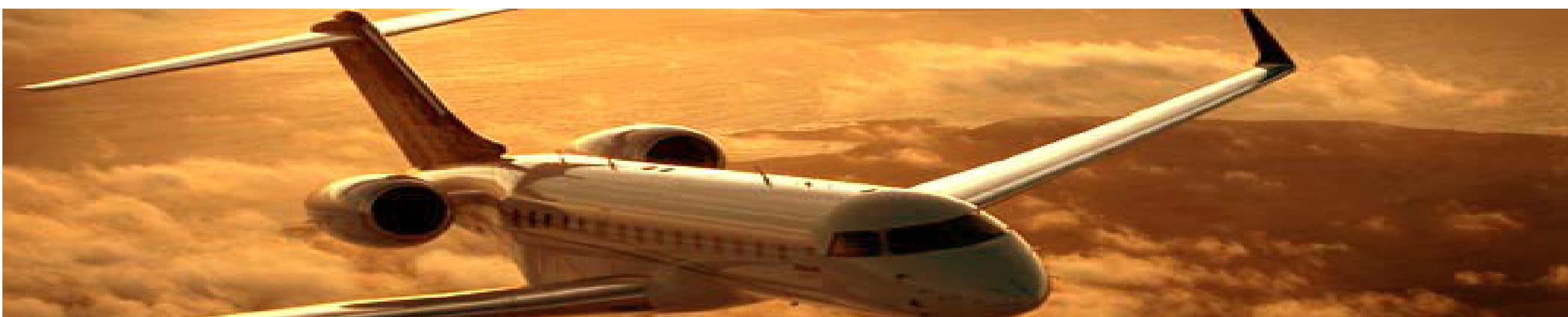
Many states permit a “trade-in-credit” or offset against the basis to which a sales tax is applied (i.e., the purchase price), in an amount equal to the value of trade-in property. In order to qualify for a trade-in credit, two conditions usually must be met. First, the trade-in property must be sold to the same person from whom the new property will be purchased (i.e., an actual exchange of property), and second, the party acquiring possession of the trade-in property must intend to hold such property for resale in the ordinary course of business. State law may also limit the trade-in credit to transactions involving an exchange of similar property (e.g., an aircraft for an aircraft).

D. Interstate Commerce Exemptions

Another exemption that is frequently available to aircraft owners is the interstate commerce exemption. Unlike the sale for resale exemption, which exists in nearly every state, in similar form, there is wide variation in the nature of this exemption from state to state. In general, the exemption derives from a recognition, by the states, that aircraft used to provide transportation services to the public should not be subject to tax, because the purchaser is not the end-user of the aircraft. In this sense, the exemption is similar to the sale for resale exemption. The aircraft buyer is viewed as a vendor of transportation services that may be taxed under a different tax regime, or not at all.

One major difference between the states on this issue is whether to exempt sales or leases to FAR Part 135 operators. Some states limit the exemption to scheduled air carriers, other states are silent on the question. Another point that varies from state to state is whether the focus should be on the use of the aircraft, or on the end user of the aircraft. Some states allow the exemption if the aircraft is used more than 50% of the time in air commerce. Other states allow the exemption only if the lessee or the purchaser of the aircraft is a certificated air carrier. Under the former, more permissive rule, a non-transportation company can purchase an aircraft and benefit from the exemption, as long as the aircraft is used by a Part 135 operator more than 50% of the time.

States have various rules on how to calculate the 50% fraction, however. Some states, such as California, include only specific types of flights, e.g. not training flights. Other states count count flight hours where passengers are carried, but not repositioning flights. To further complicate matters, there can be questions about whether the charter customers are sufficiently unrelated to the aircraft’s owner, e.g. where the charter customers are employees of an affiliate of the aircraft owner. There is frequently little guidance on how unrelated the aircraft owner and the passengers need to be. Is 10% common ownership too much? What about 50% or 80%? Like many unanswered questions in this area, the determination is often up to the discretion of state revenue agents.



E. State Specific Exemptions

In addition to the broad categories of exemptions listed above, there are a variety of state specific exemptions for aircraft transactions that are unique to particular states. For example, in Connecticut, all aircraft purchase transactions involving aircraft in excess of 6,000 pounds maximum takeoff weight are exempt from sales tax. In Florida, some taxpayers are eligible for apportionment of sales tax for leased aircraft, using a formula based on miles flown in Florida airspace. In North Carolina and South Carolina, there is a low maximum sales tax, and in Virginia, there is a special, low rate for aircraft sales. Many other unique, aircraft specific rules exist in other states