



## Three Common Myths About Purchasing and Selling an Aircraft -By Keith G. Swirsky-



You are looking to sell your aircraft and have found a potential buyer. Or maybe you have been thinking about getting an aircraft and have decided that the market is right to buy one. Before you enter into an aircraft transaction, educate yourself about these three commonly held myths so that you can minimize your taxes and maximize the protection of your interests.

### Non-Refundable Deposits

Most people tend to believe that a non-refundable deposit in escrow is as good as a non-refundable deposit in their bank account. The use of escrow agents is standard in most aircraft purchases and indeed escrow agents serve an important and essential function in aircraft transactions. However, it is important to understand exactly what having money in escrow means when a deal goes bad. Specifically, it is important for the seller to understand that an escrow agent will normally not release a non-refundable deposit to the seller without confirmation from the purchaser that the purchaser does not plan to challenge the seller's assertion of breach of contract.

It is common for the escrow agent to obtain the purchaser's consent before releasing the purchaser's deposit, even though the deposit is designated as non-refundable in the agreement. This may sound surprising, but it makes sense from the point of view of the escrow agent; the escrow agent will want to avoid liability in the event there is a dispute over whether or not the purchaser has breached the contract. In short, the escrow agent will not take the side of one party over another. That said, if the deposit is non-refundable, the facts surrounding the purchaser's breach are unequivocal, and the purchase agreement is completely unambiguous on the issue of breach of contract, the seller should ultimately get to keep the deposit.

This could happen in several ways. The purchaser could consent to the release of all, or perhaps some negotiated amount of the deposit, or, if the escrow agent fails to obtain the purchaser's consent, the escrow agent could interplead the money to the local court. Once the money has been interpleaded to the court, the seller would need to go to court to claim it. If the purchaser does not show up to court to contest the claim, the court would then most



likely issue a default judgment in the seller's favor. If the purchaser does contest the seller's right to keep the deposit, the court would then make a determination about who is entitled to the money based on the facts, circumstances and documentation in the case.

One thing is certain: the seller should not treat a non-refundable deposit in escrow as money already in the bank, even if the purchaser has "accepted" the aircraft and agreed that the deposit is non-refundable. To help protect itself in the event of a breach, the seller should ensure that the purchase agreement is very clear on matters relating to the purchaser's breach and forfeiture of the deposit. Further, the seller should attempt to document any circumstances that could give rise to purchaser's breach of contract.

### Avoiding Sales (and Use) Tax on the Purchase of an Aircraft

There are several misconceptions regarding liability for sales (and use) tax. It is commonly believed that taking delivery of an aircraft in a state that does not impose sales tax, using a Delaware entity, or finding a seller that is a retailer and does not collect sales tax effectively avoids the imposition of sales (and use) tax on the purchase. "Technically" the use of the above devices may avoid the imposition of sales tax; however, nothing has been achieved from a state tax liability perspective.

Although sales tax itself is generally only assessed by the state where the transaction occurs (in the case of aircraft, usually where the aircraft is physically delivered to the purchaser), if the aircraft is going to be based (e.g., hangared) in a state other than the one where it was delivered, the state where the aircraft is based may assess use tax. State sales and use taxes are complimentary and are generally imposed at the same rate. "Use tax" is not imposed on the sale transaction itself but rather on the use, storage or consumption of an aircraft within the borders of a state. In other words, even if sales tax is avoided on the purchase of an aircraft, planning for eliminating or minimizing use tax is still needed. To make matters more cumbersome, an aircraft can be "used and consumed" in more than one state, creating a potential for liability for use tax in multiple states.

Although there are some common planning opportunities in many states (discussed below), it is important to realize that each state uniquely applies and interprets its tax statutes. For example, application of a "sale for resale" exemption in two different states may vary significantly, hinging on issues such as minimum or maximum term of a lease, acceleration of tax due on rental payments, and apportionment, just to name a few. Some states will not impose use tax on property that is brought into the state after a certain amount of time, six months for example; other states will not impose use tax on aircraft that are used in commercial aviation (which itself is defined differently by each state); some have trade-in credits or exemptions for "casual sales;" still other states will look at how many days per year an aircraft is in the state. In addition, state law is constantly evolving, and in these lean economic times, often evolving toward a stricter and more encompassing approach to imposing use tax (and for that matter sales tax) on aircraft to help the state raise revenue.



Despite the many ways in which an aircraft may be subject to tax, it is often possible to reduce, defer or even eliminate the sales and use tax on an aircraft. While there may be exemption opportunities available on the purchase of an aircraft to avoid sales tax, if a buyer intends to base an aircraft in a state that imposes its own sales tax, there is usually no advantage in taking delivery of the aircraft in another state. Advance planning that takes into account not only where the aircraft is purchased, but where it will be used will lead to the best possible results.

### A “Simple” Transaction Can Be Handled Without an Aviation Tax Lawyer

Besides the potential to reduce, defer, or eliminate sales and use tax discussed above, the ability to take depreciation deductions, or in some cases, even bonus depreciation deductions, the ability to deduct aircraft operating expenses on the owner’s federal tax return, and utilizing Section 1031 of the Internal Revenue Code to effect a tax free exchange, are just a few of the ways good tax planning on an aircraft purchase has the potential to literally save a buyer millions of dollars.

However, saving money on taxes is not the only benefit using an experienced aviation tax and transactions attorney provides. The lawyer will structure a purchase agreement to protect the buyer or seller’s interests in case things do not go smoothly and will understand what is commercially standard on a broad range of issues. Of course, no one ever enters into a transaction thinking it is not going to close, yet everyone knows someone who has been burned by not taking the proper precautions.

One myth that is popular, especially with buyers who are eager to complete the deal and take that first flight, is that if the pre-purchase inspection goes smoothly, it lessens the importance of a well drafted purchase agreement. While it is true the pre-purchase inspection of an aircraft is the most significant aspect of the purchase process, (and if the purchaser “accepts” the aircraft after the inspection, the likelihood of a closing increases greatly), it is still also true that a well drafted purchase agreement clarifies a myriad of issues that are critical to the parties’ rights and obligations arising both before and after closing.

While a detailed discussion of the preparation of a comprehensive purchase agreement is not the subject of this article, it is worth mentioning a few important points that are often overlooked by the parties until something goes wrong: (i) whether the purchaser is obligated to accept the aircraft at the conclusion of the inspection or may reject the aircraft for any reason; (ii) whether the seller must correct discrepancies or may choose not to do so; (iii) whether the aircraft has damage history and the definition of “damage” for these purposes; (iv) the responsibility of the parties if the aircraft is damaged prior to closing and the different definition of “damage” for these purposes; (v) how to deal with errors in the specification sheet advertising the aircraft; (vi) international and domestic registration and deregistration issues; (vii) the timing of release of funds out of escrow; (viii) assurance that the taxes and fees on aircraft are paid through closing; and (ix) responsibility for sales taxes.



When it comes to comprehensively documenting an aircraft, or any other purchase transaction, the legal documentation may never need to be read again if the parties perform in every way as each party expects and requests. So you may ask why it is worth the time and money, and possibly even aggravation to use a lawyer to document a deal? Simple, too often people fail to perform as expected, sometimes through no fault of their own. Before you decide to forgo executing a comprehensive purchase agreement you should ask yourself, what is your tolerance for risk, and do you want to know that if you do end up in a battle, you will be well protected?

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