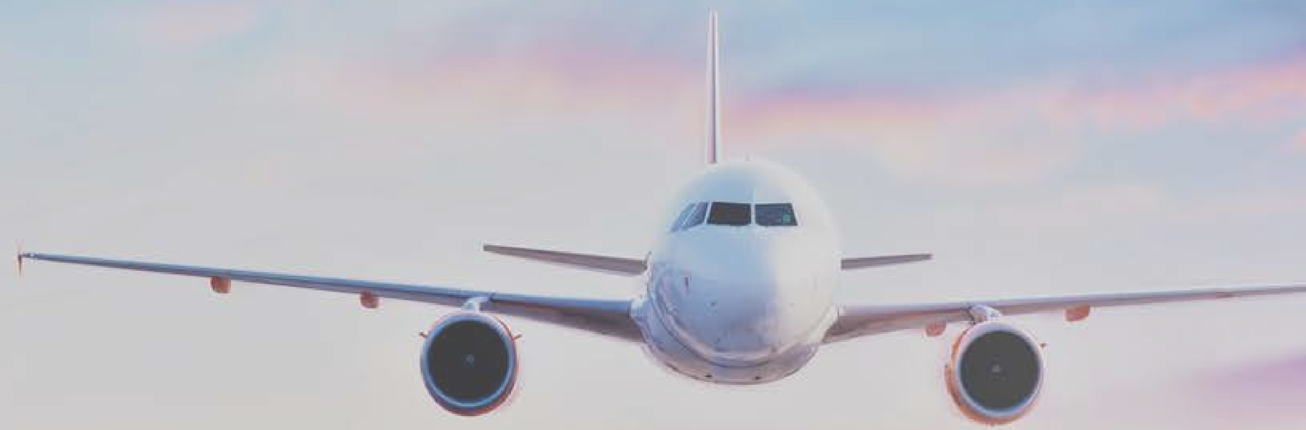

Sales & Use Taxes on Business Aircraft

Latest Developments & Key Planning Tools

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Upcoming Webinars

Federal & State Tax Audit Defense	January 21, 2021 1 p.m. ET
Significant Issues in Aircraft Purchase & Sale Documentation, Including Import/Export	February 18, 2021 1 p.m. ET

Sales & Use Taxes on Business Aircraft
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Sales & Use Taxes on Business Aircraft
Overview

- Key sales and use tax concepts
- Sales and use tax nexus
- Planning considerations
- Specific exemptions
  - Fly away
  - Occasional / isolated / casual sales
  - Sales for resale
  - Interstate commerce
  - Common carrier / commercial aircraft

Sales & Use Taxes on Business Aircraft
Overview

- State sales and/or use tax credits
- Fractional shares
- Sales tax update
  - Ohio
  - Colorado

Sales & Use Taxes on Business Aircraft
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., hangered).
- Sales tax can be easily avoided, but avoiding use tax is more difficult.
- Sales/use tax is generally a one time tax, not an annual tax (cf. personal property taxes/annual aircraft registration fees).

Sales & Use Taxes on Business Aircraft
Introduction

- Sales/use tax planning is primarily based on ownership structuring – form over substance (cf. federal income tax planning, which typically relies on substance over form).
- However, some states now analyze aircraft ownership structures based on substance over form.
- Sales tax analysis and planning should be performed at the outset of an aircraft acquisition and before completing analysis and planning of other tax and non-tax matters, as the sales tax planning recommendations provide the structural foundation for the balance of the tax planning and FAA/DOT compliance.

Sales & Use Taxes on Business Aircraft
Introduction

- Although state law exemptions may be referred to by the same name, the requirements for their implementation varies significantly from state to state.
- Timing and implementation mechanics must be followed precisely.
- The use tax rate in a 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 a use tax, but not both, on an aircraft.

Sales Tax

- Most states impose sales/use tax on the purchase of tangible personal property (e.g., aircraft).
- The sales/use tax rate is generally between 2% and 12% of the aircraft purchase price/FMV.
- Sales tax is a transaction-based tax and will apply only in the state where the transaction occurs (i.e., the aircraft delivery location).
- Jurisdiction to impose state sales or use tax is referred to as *nexus*.

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 provided that the aircraft has substantial nexus with the state seeking to impose such tax.

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Use Tax

- Use tax nexus normally attaches to the locations where the aircraft is used, meaning where it is "based" or regularly hangered.
- 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 in a state that will lead to a use tax assessment on an aircraft varies (in some a single use will trigger, in other states it must be used within the state for a certain period of time).

Sales & Use Taxes on Business Aircraft
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 of taxability can be difficult and the process for doing so varies from state to state.
- Tools that may be used 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 aircraft personal property tax paid to another state.

Sales & Use Taxes on Business Aircraft
Planning Considerations

- If an aircraft will be based in a state that imposes use tax, there may be no net tax advantage to taking delivery of the aircraft in a state that exempts the aircraft from its sales tax.
- State of incorporation/formation of the ownership entity will not create a sales or use tax advantage, but can create a disadvantage (e.g., by creating nexus with the state of incorporation/formation).
- Carefully consider mailing/street address used on FAA Application for Aircraft Registration (Form 8050-1).

Sales & Use Taxes on Business Aircraft
Specific Exemptions

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

Sales & Use Taxes on Business Aircraft
Fly Away Exemption

- Sales tax exemption
- Typically available only to non-residents of the state of delivery
- Time restrictions
- Usage restrictions
- Re-entry can invalidate

Sales & Use Taxes on Business Aircraft
Occasional/Casual Sales Exemptions

- Sales/Use tax exemption for used aircraft
- Focus in most states is on the seller's status as a casual/occasional seller. Some states also look at buyer's status
- Many differences in requirements between states

Sales & Use Taxes on Business Aircraft
Sale for Resale Exemption

- Property is purchased exclusively for the purpose of resale (lease).
- Sales tax is then collected on the receipts from the resale (lease) of the property unless such receipts are otherwise exempt.
- In most states a lease is considered a sale for sales and use tax purposes (cf., California and Illinois).
- In states where leases are considered sales, an aircraft leasing structure may allow for the aircraft purchaser to be exempt from use tax on the aircraft and for sales tax to be paid on lease rent instead.

Sales & Use Taxes on Business Aircraft
Qualifications

- In most states, the aircraft owner/lessor must be qualified to transact business in the state and properly 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 of the aircraft effective on the date of the aircraft purchase.

Sales & Use Taxes on Business Aircraft
Sale for Resale Exemption Pitfalls

- Some states have lease rent acceleration requirements (e.g., New Jersey) pursuant to which the sales tax must be paid on the rent due during the entire lease term up front.
- To avoid problems with related party lease, 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 or leases between entities that are disregarded for state income tax purposes.

Sales & Use Taxes on Business Aircraft
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.

Sales & Use Taxes on Business Aircraft
Sale for Resale Exemption

- The payment of sales tax on rent instead of paying use tax on the aircraft when purchased normally results in significant overall tax savings in lease structures with aggregate terms of 10 years or less.

Sales & Use Taxes on Business Aircraft
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.

Sales & Use Taxes on Business Aircraft
Common/Commercial Carrier Exemption

- Generally requires aircraft to be owned or used by an FAA authorized air carrier.
- Some states limit the application of the exemption to scheduled carriers while other states also include on-demand carriers.
- Some states disallow the application of this exemption in situations where all or substantially all of the use is by parties that are related to or affiliated with the owner.

Sales & Use Taxes on Business Aircraft
State Sales Tax Credits

- Generally, one state will allow a credit for the amount of sales or use tax “properly paid” first to another state.
  - Exception: Aircraft dry leases and tax on rent paid thereunder.

Sales & Use Taxes on Business Aircraft
Trade-in Credit

- Trade-in credit is that portion of the purchase price "paid" with the trade-in property rather than in cash.
- It is possible to utilize a trade-in credit by structuring the transaction to meet the requirements of a particular state's trade-in credit statute.
- Implementation requirements are normally complex since a sales tax "dealer" must be involved in the trade-in in most cases.

Sales & Use Taxes on Business Aircraft
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 (e.g., Ohio).
- Taxpayers should examine use tax law in state where fractional interest owner is considered a "citizen" for state tax purposes.
- Some states have specific rules regarding application of their sales and use taxes to fractional shares.

Sales & Use Taxes on Business Aircraft
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 state with a fixed sales tax on fractional interests in aircraft is generally not helpful to alleviate this risk).
- Consider planning to meet an exemption, such as “sale for resale.”

Sales & Use Taxes on Business Aircraft
Recent Developments

- Arkansas: Broadened the application of its fly-away exemption in 2017.
- Arizona: Common carrier exemption effective July 1, 2017 applies to 135 operators.
- Colorado: Governor vetoed 2018 legislation creating a sales and use tax exemption for Part 135 operators.
- New Hampshire: Still no sales or use tax; aircraft registration fees for larger/newer aircraft lowered substantially.
- Ohio: December 2018 Ohio Supreme Court case disallowing application of resale exemption to related party leasing structure.
- Oklahoma: Effective 5/10/18, the common carrier exemption requires greater than 50% of use of aircraft to transport unrelated third parties.
- Texas: Regulations published in 2017 relating to 2015 law containing provisions clarifying sale for resale/leasing structure requirements and parameters.
- Tennessee: Lengthened removal time for fly-away exemption to 30 days; Added parts & labor exemption for large aircraft.

Sales & Use Taxes on Business Aircraft
Florida: Six Month Rule for Non-Residents

- General requirements for six month rule apply.
- Aircraft owned by non-resident may 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 Florida use tax.
- Does not work with leased aircraft using sale for resale exemption.

Sales & Use Taxes on Business Aircraft
California: Interstate Commerce Exemption

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- California has both an Interstate Commerce Exemption (Regulation 1620) and a Common Carrier Exemption (Regulation 1593).
- The requirements for the Interstate Commerce Exemption include:
  1. Must acquire the aircraft outside of California.
  2. The first functional use of the aircraft (i.e. an interstate or international business or commercial flight) must be outside of California.
  3. 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.

Sales & Use Taxes on Business Aircraft

California: Common Carrier Exemption

- 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.

Sales & Use Taxes on Business Aircraft
California: Exemption Comparison

- The Interstate Commerce Exemption is generally preferred because:
  - The test period is shorter (6 months for the Interstate Commerce Exemption versus 12 months for the Common Carrier Exemption).
  - The amount 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 & Use Taxes on Business Aircraft
Various State Provisions

- Alaska, Delaware, New Hampshire, Montana and Oregon – no sales tax (beware of personal property tax, gross receipts tax and registration fees) (Some localities in Alaska impose a sales tax).
- Connecticut – exempts aircraft having a maximum gross takeoff weight of 6,000 pounds or more.
- Maine, Massachusetts, New York, and Rhode Island – have broad aircraft sales and use tax exemptions.
- Illinois – rolling stock exemption is the only viable sales and use tax planning tool for aircraft based in Illinois.
- North Carolina and South Carolina have low caps on the amount of sales and use tax on aircraft.
- Virginia imposes an aircraft sales and use tax at a lower rate (2%) than other types of sales/uses, but there are very few exemptions from the tax.
- Florida has multiple special rules relating to imposition of its sales and use tax on aircraft.

Questions?

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