State Sales and Use Tax: Myths and Truths

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THE MYTHS:

How often have you been at a social gathering and a friend or colleague proudly mentions that they just purchased a corporate jet and then proceeds to mention that no sales tax was paid on the transaction? You are told, "my attorney formed a Delaware corporation, and as you know, no sales taxes are due in the State of Delaware." Or, you hear, "the seller had me fill out a sales tax exemption form, and didn't collect sales tax on the transaction." In particular, if your friend acquired a fractional aircraft share, undoubtedly what's said is, "the salesman told me that no sales tax is due on the transaction." Consequently, your friend or colleague has not paid sales tax on the acquisition of their new corporate jet. Surprising as it may be, I have also heard numerous times that the buyer paid the full sales tax on the purchase price of the aircraft and didn't even consider the possibility that the purchase was exempt from state sales tax. As a general statement, none of the foregoing scenarios portray an accurate picture of a buyer's liability for state sales and use tax on the acquisition of a corporate jet.

In order to properly plan for elimination or reduction of state sales and use tax associated with the purchase of a corporate jet, it is critical to retain an aviation tax professional. It is surprising that many aircraft buyers, do not consider it necessary to retain an aviation tax professional in connection with the purchase of a multi-million dollar corporate aircraft. Often times, the general corporate counsel, or the company's accountants, are consulted on the purchase of the aircraft, however, inasmuch as these advisors do not regularly engage in aviation transactions, they do not possess the necessary expertise to advise on a corporate aircraft purchase. This is not say that these individuals are not necessarily sales and use tax experts. However, proper state sales and use tax planning requires consideration of all other factors that go into structuring an aircraft transaction. These other factors include compliance with Federal Aviation Regulations, consideration of Federal Transportation Excise Taxes, utilization of depreciation deductions, deduction of operating expenses, economic and cash flow considerations, and liability protection planning. All of these issues must be factored together in a sort of "melting pot" to come up with one harmonized structural result.

THE TRUTHS:

Nearly all states impose sales and use taxes on aircraft purchase transactions. The tax rate for the sales tax in any specific state will be identical to such state's use tax rate. Sate sales and use taxes are mutually exclusive, and are complementary. In other words, with respect to a corporate aircraft, a state will generally assess either a sales tax or a use tax, but not both.

The sales tax is a transaction based tax and will apply only in the state where the transaction occurs; in the case of an aircraft, that is generally where the aircraft is located on the closing date. In the event state sales tax is due on the transaction, due to an available exemption, or the possibility that a particular state does not impose a sales tax on this type of transaction, it is necessary to examine whether there is a liability for state use tax.

Use taxes are imposed by a specific state on the basis of use, storage, or consumption in the state of the aircraft, when the aircraft is acquired outside the state and subsequently brought into the state. Whether a state will impose its use tax depends on the structure of the transaction and the state's use tax laws. Some states impose a use tax on the first use of property in the state, while other states impose a use tax only on property used in the state within a certain period of time after it was purchased, and other states impose the use tax upon the presence of property in the State for a specified number of days. Some states use a very subjective standard such as whether the property in question has become a part of the "mass of property" of the taxpayer located within the state.

PLANNING CONSIDERATIONS:

It is entirely possible to avoid sales tax on the purchase of an aircraft. The typical methods of avoiding sales tax are either to take delivery of an aircraft in a state that does not impose sales tax, or in a state that has an applicable fly-away exemption. Fly-away exemptions differ from state to state, so in the event you hear that the state has a fly-away exemption, it is necessary to review the state law statute to determine the specifics and scope of the state law exemption. However, avoiding sales tax on the purchase of the transaction is ***far less important*** than avoiding use tax on the use and operation of the aircraft subsequent to delivery. As discussed above, even if a purchaser avoids sales tax incident to the purchase of a corporate aircraft, once the aircraft is relocated to the buyer's home state, such home state may be able to impose a use tax in a manner equivalent to the result had the aircraft purchase transaction closed in such State.

As a result, there is no benefit to the aircraft buyer, generally speaking, to close the aircraft purchase transaction while the aircraft is located in a state that does not impose sales tax or that has an applicable fly-away exemption. There can be a detriment, however, to closing the aircraft transaction in such state, if it is not absolutely certain that the buyer will comply with the fly-away exemption requirements, because of the possibility that a sales tax liability will accrue. The one notable exception to this generalization is if the buyer is relying on a "non-residency" exemption in their home state, and the non-residency exemption in their home state requires delivery of the aircraft to occur outside of the home state, or if the buyer is relying on some other form of exemption, such as an "interstate commerce" exemption, again requiring the buyer to take delivery of the aircraft outside of the state.

As mentioned above, it is also not advisable to form a Delaware corporation or limited liability company with the expectation that the Delaware entity will shield the transaction from applicable sales or use taxation. The state of formation of the corporation or limited liability company that owns the aircraft generally speaking does not help insulate the transaction from sales or use tax. In some cases, however, the state of formation of the aircraft owning entity can hurt in the planning process. This is because some states look at the state of formation of the aircraft owning entity as a significant factor in determining whether they may apply their sales and use tax statutes to tax the purchase of the aircraft.

As can be seen, when a buyer intends to hangar and permanently base an aircraft in a state that imposes sales and use taxes, there is seldom any real tax advantage to taking delivery of the aircraft in another state in an attempt to avoid paying a sales tax.

In planning to eliminate or reduce applicable sales and/or use tax, each state has its own specific statutory provisions. It is important to understand, that generally form over substance controls for sales and use tax purposes. In other words, the specific legal structure, documentation, and cash flow associated with the ownership and operating structure will generally dictate the sales and use tax ramifications.

There are numerous exemptions around the United States including exemptions related to isolated and occasional sales, exemptions for bringing an aircraft into a state after a specified amount of time (e.g., six months), exemptions for a non-resident who subsequently becomes a resident and thereafter brings a previously owned aircraft into the state and exemptions for use of the aircraft in common carriage or interstate commerce. There are also ways to reduce tax by utilizing a trade-in credit and, most notably and most often utilized, ways to reduce sales and use taxes by utilizing a "leasing" structure for the aircraft.

Although a state may use the same definitions as another state, it is absolutely imperative to examine the mechanics of complying with the exemption. For example, in a typical leasing structure most states would require the collection of a use tax on the rental payment on a "pay as you go" basis, but several states require a calculation of all of the rental due under the term of the lease and use tax to be paid up front on such aggregate amount. Finally other states prohibit the leasing exemption if the term of the lease does not exceed a certain duration, such as one year.

All of these detailed and mechanical considerations must be thoroughly examined to properly structure a transaction to eliminate or reduce applicable sales and use taxes. Proper planning and use of an aviation tax professional provide the greatest possibility for complying with these statutes, while also factoring in numerous other considerations in the *melting pot* analysis.

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