



Controlling Sales Tax on the Purchase of Your Aircraft

One major cost in the purchase of any aircraft is sales and use tax. Because of the portability of an aircraft, it is easy to avoid sales tax on the purchase by closing in a jurisdiction with little or no tax or with an applicable exemption, but the use tax can become an issue in the state in which the aircraft is based.

Sales and use tax terms are not universally defined in all jurisdictions, but for the purposes of this discussion, a **sales tax** is a privilege or license tax on people making retail sales by which ownership of tangible personal property is transferred. **Use tax** compliments sales tax and is a tax on the consumer for the privilege of storing, using, or consuming any tangible personal property. The sales tax and use tax are generally mutually exclusive, and neither applies where the other was paid.

Because aircraft are easily transportable, sales tax can be eliminated by making the transaction in a state where there is no sales tax, such as New Hampshire or Montana. Other states, including Massachusetts, South Carolina, and North Carolina, have little or no sales or use tax on aircraft purchases. Finally, over a dozen remaining states have “fly-away exemptions” stating that an aircraft will not be subject to tax if it is immediately removed from the state

and registered elsewhere. However, these exemptions are narrowly construed, so a purchaser needs to exercise extreme care in the point of delivery and closing of the transaction.

Although movement of an aircraft can generally manage the sales tax, the use tax in the state of residence of the aircraft is another matter. Use tax will often be imposed by the state of residence if sales tax would have been imposed had the transaction occurred within the state. Culminating the sale in a sales-tax-free state is only the initial step in controlling sales and use taxes; therefore, the purchaser must find a use tax exemption, which often includes the following:

- 1. Common Carrier Exemption** A common carrier exemption is not unique to aircraft, but it often applies to transportation equipment used in the movement of people and property for hire. Several states have a common carrier exemption that applies only to commercial airlines; however, many states exempt charter operators working under FAR Part 135, provided threshold use tests are met. Under certain circumstances, selected states will extend the common carrier exemption to aircraft operators serving members of their controlled group and operating under FAR Part 91.

- 2. Casual Sale** This exemption applies to aircraft sales by individuals or companies not regularly engaged in the aircraft sale business. A number of state laws that include a casual sale exemption specifically carve out aircraft from the exempt property designation and tax their sale.
- 3. Resale Exemption** Because the sales and use tax is a tax at retail, the purchase of the property will generally not be subject to tax if it is acquired in a wholesale transaction. This wholesale exemption would apply when an aircraft is acquired for purposes of resale or for lease. Therefore, when a dealer acquires an aircraft to sell it to another, tax is imposed on the dealer sale but not on his purchase. Likewise, when property is acquired for lease to another, the acquisition of the property is generally exempt from sales tax, while the lease payments are then subject to it.
- 4. Interstate Exemption** Certain states recognize that if an aircraft is used primarily in interstate commerce, it is not subject to either sales or use taxes. The scope of this exemption generally turns on the level of interstate use and the degree in which it resides in the state.
- 5. Trade-In Allowance** This is a partial exemption that results in an exclusion of a portion of the purchase price of the aircraft for the value of a trade-in. Generally, the sales tax trade-in allowance requires that the trade-in be a simultaneous two-party exchange. Although federal income tax rules provide for a non-simultaneous three-party exchange, these do not often result in sales tax savings.
- 6. Entity Sale** Because sales tax is imposed on the sale of tangible personal property and the sale of stock or membership interest is an intangible, sales tax will often not be imposed on entity purchases.
- 7. Corporate Transactions** In a number of states, there are exemptions for bulk sales of property as part of an ongoing trade or business, statutory mergers, dividends to shareholders, tax-free contributions of property to partnerships or corporations, and other similar transactions. It is often possible to structure transactions pursuant to these use-tax exemptions, effectively limiting the applicability of use tax.

The sales and use tax law is a tax on transactions where form is imperative. The states are generally very restrictive in the granting of exemptions and strictly construe statutory requirements. Although states will often provide credit for sales tax paid to another state, that is not universally true. It is therefore possible for you to inadvertently subject your aircraft to sales or use tax in multiple jurisdictions.

Although the states are very precise in their requirements of form, a number of them have started to attack transactions by asserting lack of substance. Although “form over substance” arguments are just emerging, some states are attacking lease transactions as “sham transactions” administratively. Although the courts will undoubtedly decide these issues, aircraft purchasers need to understand the position of the state tax department at the time of acquisition.

In an attempt to expand taxation on interstate transactions and provide basic uniformity in sales tax administration, 18 states have adopted the “Streamline Sales and Use Tax Agreement,” effective October 1, 2005. Although this agreement provides uniform sourcing rules on leases, it does not require uniform use tax exemptions.

The sales and use tax law applicable to airplanes is exceedingly complex and is often not uniformly clear. As the states’ tax appetites continue to grow, they appear to be increasingly aggressive, even in areas previously thought to be exempt from tax. Purchasers are therefore cautioned to plan their transaction carefully and to obtain a ruling from their state authorities.

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