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CONTROLLING SALES/USE TAX ON THE PURCHASE OF YOUR AIRCRAFT

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

Although sales and use tax terms are not universally defined in all jurisdictions, for purposes of this discussion a sales tax is a privilege or license tax on persons engaged in the business of making retail sales by which ownership of tangible personal property is transferred for consideration. Use tax compliments sales tax and is a tax on the consumer for the privilege of storing, using, or consuming within the state any tangible personal property. The sales tax and use tax are generally mutually exclusive, in that any sales tax already paid on the transaction will be credited against use tax owed.

Because aircraft are easily transportable, sales tax can be eliminated by transacting the transfer in a state such as New Hampshire or Montana which have no sales tax. Other states have little or no sales and use tax on aircraft purchases, including North and South Carolina. Finally, over a dozen remaining states have “fly-away exemptions” that provide an aircraft will not be subject to tax if it is promptly removed from the state and registered elsewhere. However, these exemptions often have technical requirements that must be carefully considered before relying upon them. Aircraft sales/use tax is an area of extreme differentiation from state-to-state, so parties must exercise extreme care in determining the point of delivery and closing of the transaction.

Although the sales tax can generally be managed by movement of the aircraft, use tax is generally another matter. Use tax will generally be imposed by the state of domicile (and possibly even in other states with nexus to the aircraft) if sales tax would have been imposed had the transaction occurred within the state. Therefore, culminating the sale in a tax-free state is generally only the initial step in controlling sales and use taxes. The purchaser should also plan for avoiding or minimizing use tax, through one of the various exemptions that may be available on a state-by-state basis. Examples of common exemptions (which may or may not be present in any particular state) include:

- ➔ Common Carrier Exemption. Common carrier exemptions, if present, are often not unique to aircraft, but may apply more broadly to transportation equipment used in the movement of persons and property for hire. Several states have common carrier exemptions that applies only to commercial airlines. However, many states exempt charter operators operating under FAR Part 135, provided certain threshold use tests are met. Under certain circumstances, selected states will even extend the common carrier exemption to aircraft operators serving members of their controlled group and operating under FAR Part 91.



- Casual Sale. These exemptions apply to the sale of aircraft by individuals or companies not regularly engaged in the aircraft sale business. One potential hazard is that a number of state laws which include a casual sale exemption specifically carve out aircraft from the exempt property designation, and therefore tax it.
- 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 transaction exemption would generally apply when the aircraft is acquired for purposes of resale or for lease. Therefore, when a dealer acquires an aircraft for the purpose of selling it to another, tax is imposed on the dealer sale, but not 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.
- 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 to which it resides in the state.
- 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. Often, sales tax laws require that the trade-in be a simultaneous two-party exchange. Although federal income tax rules provide for a non-simultaneous three-party exchange, states vary as to whether they accept such exchanges in granting a trade-in allowance.
- Entity Sale. Because the sales tax is generally imposed on the sale of tangible personal property, and the sale of stock or membership interest is an intangible, sales and use taxes will generally not be imposed on entity purchases.
- Corporate Transactions. In a number of states there are exemptions for bulk sales of property as part of the sale of an on-going trade or business, statutory mergers, dividends to shareholders, tax-free contributions of property to partnerships or corporations, and other similar transactions. In some cases, it may be possible to structure transactions pursuant to these exemptions and thereby effectively limit the applicability of sales/use taxes.

The sales and use tax law focuses intently on the form of each particular transaction. The states are very restrictive in the grant of exemptions, and strictly construe statutory requirements. Although, generally, states will 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 asserting lack of substance. Although “form over substance” arguments are recently emerging, some states are attacking lease transactions as “sham transactions” administratively. Although these issues will undoubtedly be ultimately decided by the courts, aircraft purchasers need to understand the respective 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, 24 states (as of July, 2021) have adopted the “Streamlined Sales and Use Tax Agreement.” 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 aircraft 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 carefully plan their transactions and be cognizant of potential risks.

July 21, 2021, rev.

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Advocate Consulting Legal Group, PLLC is a law firm whose practice is limited to serving the needs of aircraft owners and operators relating to issues of income tax, sales tax, federal aviation regulations, and other related organizational and operational issues.

This article provides an introduction to a complex, and often ambiguous, area of law. Knowledgeable people may disagree as to outcomes in particular cases. Always consult with your advisor.

