

Common Sales Tax Myths in Aircraft Transactions

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An important and often glossed over part of every aircraft transaction is state sales and use taxes. State sales/use taxes are complicated, confusing and frequently misunderstood, and each state has its own set of obscure (and sometimes ambiguous) rules. The average U.S. state sales tax is approximately 8.5%, so there can be a multimillion-dollar tax liability on a private aircraft sale by overlooking state taxes. However, many aircraft transactions occur with little attention paid to state taxes, often due to myths and false beliefs about state sales/use tax. Generally, a sales tax is a state transactional tax on the purchaser of tangible personal property that is collected by the seller from the purchaser, and then remitted by the seller to the state, unless an exemption applies. This article busts some sales/use tax myths affecting aircraft transactions.

- **Myth #1:** “The aircraft was delivered in a state without a sales tax, so there is no state tax liability when the aircraft is moved to its new home base.”

Busted. This purchaser is overlooking state “use” taxes. In addition to sales tax, a state may impose a “use tax” on the use, storage or consumption in the state of an aircraft acquired outside the state and subsequently brought into the state. The use tax is basically a “backstop” tax that applies to the use of property in a jurisdiction when the sales tax did not apply to the purchase of that property. So, if an aircraft is delivered to a buyer in a sales tax-free state, but then hangared in New Jersey, there will be a New Jersey “use” tax owed based upon the purchase price of the aircraft (unless a specific New Jersey tax exemption applies).

- **Myth #2:** “I paid sales tax of \$300 on delivery of the aircraft in South Carolina, so I don’t owe sales tax anywhere else.”

Busted. If an aircraft is delivered in a low-tax state, such as South Carolina or North Carolina, and thereafter the aircraft is hangared in a state with a “use” tax, the aircraft owner will still be subject to that state’s use tax, regardless of whether sales tax was paid to the state where the aircraft was delivered. The aircraft owner’s use tax liability is likely reduced by the amount of sales tax paid to the state of delivery, but this credit could be nominal if delivery is in a low-tax state.

- **Myth #3:** “I’m not a resident of the state where the aircraft was delivered, so state sales tax does not apply to me.”

Busted. Sales tax applies in the state where the aircraft is physically delivered. Therefore, only the location of the aircraft at the time of delivery matters for sales taxes.

Where the purchaser resides, is incorporated or maintains a principal place of business is irrelevant. Fortunately, aircraft are mobile assets, and there is flexibility in deciding where to deliver the aircraft. The Aircraft Purchase Agreement (APA) should provide for the aircraft's delivery location. Although an aircraft closing is "virtual" because the buyer and seller, and their representatives, the lender, the escrow agent and the brokers may all be at different locations throughout the world during the closing, the aircraft has to be physically delivered to the buyer's representative. Sellers typically want the delivery location in the APA to be the same place as where the aircraft inspection occurred so there is no need to move the aircraft, which takes some time and involves cost, but more importantly (from the seller's perspective) avoids the possibility of damage to the aircraft during the aircraft's movement, while risk of loss is still with the seller. The seller's legitimate concerns aside, the purchaser will not want to automatically concede to the inspection facility being the delivery location because of sales taxes, which are the buyer's burden. Therefore, before signing the APA, the purchaser should know the sales tax consequences of accepting delivery of the aircraft at the proposed delivery location. Even better, the purchaser should decide where the delivery location should be. Most sellers will defer to the purchaser's desired delivery location, but will retain operational control over the movement of the aircraft from the inspection facility to the delivery location, and will require the purchaser to reimburse the seller for aircraft movement costs.

- **Myth #4:** "I used a Delaware corporation to buy the aircraft, and there's no sales tax on this aircraft in Delaware."

Busted again. Just like Myth #3, this purchaser does not realize that only the location of the aircraft at the time of delivery matters for sales taxes, not the purchaser's state of incorporation.

- **Myth #5:** "I don't have to pay sales tax because I'm flying out of the state where the aircraft was delivered after the closing."

Sometimes busted. In many states, there is no sales tax imposed on the sale of an aircraft if the aircraft is delivered within the state, but then immediately flown out. However, in some states, this "fly-away" exemption only applies to new aircraft manufactured in the state, and failing to notice this hypertechnical rule can be an expensive tax lesson.

- **Myth #6:** "I'm the seller. If there's a sales tax on this aircraft transaction, it's the purchaser's problem."

Mostly busted. If a seller fails to collect the required sales tax from the aircraft purchaser, then the seller can be on the hook with the state for the unpaid taxes, plus interest and penalties. A well written APA (from the seller's view) will contain a tax clause expressly providing that the purchaser is responsible for all sales and use taxes. Since it is usually the seller's responsibility to collect sales tax from the purchaser for the benefit of the taxing state, a seller who fails to collect can be personally liable for the

purchaser's unpaid sales taxes. Therefore, aircraft sellers should know their state sales tax obligations when selling an aircraft. Unless there is no state sales tax, a seller will either need to collect sales tax or receive from the purchaser a properly completed sales tax exemption certificate that the seller keeps in his or her records. An ideal tax clause (again, from the seller's view) contains an agreement by the purchaser to indemnify and hold the seller harmless against any sales tax issues relating to the aircraft's sale.

- **Myth #7:** "I'm the purchaser, and my aircraft will be based in a state with a sales and use tax. There's nothing I can do. I'll have to pay state taxes on the purchase price of the aircraft."

Busted into pieces. There are numerous exemptions that can apply to minimize or eliminate state sales and use taxes. Sales/use tax planning in many states will allow a separate business entity to purchase an aircraft sales/use tax-free pursuant to a "sale for resale" exemption. Under this structure, no sales/use tax on the aircraft's purchase is owed, and instead sales tax is collected on aircraft lease payments. However, it may not be possible for the purchaser to put the aircraft into the desired holding company without a permissive assignment clause in the APA. Normally, one would not associate an assignment clause with sales/use taxes, but the two are linked. An APA generally denies the purchaser the right to assign his or her interests in the contract to another entity. However, a purchaser may want to assign the APA for a number of reasons, such as financing/lender requirements, regulatory compliance, and federal and state tax planning. It is possible that the seller would agree to amend the APA to allow for this assignment, but the seller might want something for this concession or the seller could say "no" because of other problems with the aircraft transaction. In any regard, the assignment by the purchaser to a related entity for tax planning would generally not relieve the purchaser's performance obligations under the APA, even after the assignment.

- **Myth #8:** "I can deal with state sales and use tax issues after the closing."

Busted as wishful thinking. State tax law is very formalistic, and so every "t" must be crossed and "i" dotted to avoid giving a state the opportunity to impose its taxes. Prior to closing, the purchaser's state sales/use tax planning may require the purchaser to register as a "retail dealer" with the state where the aircraft will be hangared, and the purchaser may also need to put an aircraft lease into place prior to closing. It can be several days or longer before a state issues the purchaser a retail dealer "certificate" or "registration number" that allows the purchaser to take title to the aircraft without being liable for state taxes. This can delay the closing if not properly planned for, and possibly violate the APA if the timing requirement for closing is not met by the purchaser.

Also, based upon the state sales/use tax planning, the aircraft may need to be moved from the inspection facility to a different delivery location. The delivery location is oftentimes on the ground in a low-tax or no-tax state, a state with a special "fly-away" exemption or the state where the aircraft will be based. The aircraft movement logistics and costs incurred due to sales/use tax planning need to be managed and resolved prior to closing, including the responsible party's payment of the movement costs. Also, the closing and

transfer of aircraft title from seller to purchaser needs to be timed to coincide with the aircraft's delivery to the purchaser at the desired delivery location, which can sometimes be mid-flight while the aircraft is over international waters or a tax-friendly jurisdiction.

State taxing authorities look for any excuse to impose sales/use tax on an aircraft purchaser/owner. Therefore, it is vitally important that the delivery location for the aircraft be thoroughly substantiated. The purchaser can document the aircraft delivery by purchasing fuel on the purchaser's credit card at the delivery location, and keeping a copy of the fuel invoice and credit card receipt/statement. A purchaser should obtain a flight tracker printout of the aircraft showing its flight into and out of the delivery location. It is also advisable to take a picture of the aircraft at the delivery location on a digital camera with a date/time stamp, showing the aircraft's registration number, distinguishing background and a smiling purchaser's representative.

- **Final Myth:** "This is my third aircraft, and I've never paid sales tax or use tax."

You are very lucky. Your aircraft must have been delivered in a state without sales tax, hangared in a state without use tax, and you avoided other states' claims that your aircraft has sufficient tax "nexus" with their state. In any other aircraft ownership scenario, you are lucky if you avoided paying sales/use tax. It is better to be lucky than good, but it is advisable not to rely on luck in lieu of sales/use tax planning for aircraft, given the potential adverse tax consequences.

Conclusion

State sales and use taxes can easily be neglected. There are many myths about sales/use taxes, and federal income tax issues attract the most attention. After completing federal tax planning, sales and use taxes are an afterthought that can be diminished or forgotten, but as the busted myths in this article show, sales/use tax oversight can be unexpectedly and unnecessarily expensive.

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