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NEWSLETTERS

Implications Of The 'Lessor' And 'Fly Away' State Tax Exemptions Associated With Aircraft Purchases

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It is well-established law in the United States that a taxpayer may, through legal means, avoid or decrease its tax burden, thanks to the 1935 U.S. Supreme Court decision in *Gregory v. Helvering* that says, "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

This legal insight broadly describes state tax treatment of the purchase of an aircraft and related exemptions, including examples of state sales tax laws, exemptions and potential pitfalls that can arise in attempting to claim exemptions to state sales tax.

Such exemptions come in many forms, but this review is limited to the two most utilized by taxpayers who are purchasing aircraft: the "lessor" exemption and the "fly away" exemption.

Lessor Exemption

In general, the lessor exemption is a form of resale exemption and provides that a lessor may elect to pay use tax on receipts from the rental or lease of tangible personal property in lieu of payment of sales or use tax on the full cost of the property at the time of purchase. Many states incorporate some form of this exemption into their tax code.

In most states, the taxpayer must timely obtain a sales or use tax license prior to the purchase of an aircraft, enter into an aircraft lease agreement within a proscribed number of days after closing, and timely remit use tax

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payments to the state's department of revenue or treasury. Here are a few examples that provide a cross-section of different state requirements that a taxpayer could encounter:

- Indiana only permits election of the exemption if use tax is remitted on lease payments equivalent to 7.5 percent of the purchase price of the aircraft per year.
- Michigan allows a qualified lessor to elect to pay use tax on the receipts from the rental of an aircraft in lieu of payment of sales or use tax on the full cost of the property, but one condition is that the lessor charges a rental rate based upon fair market appraisal.
- Ohio requires that a taxpayer pay all taxes due under the lease at the onset, rather than monthly.
- Louisiana and Texas consider a lease between related parties only if the monthly rental receipts is approximately 1 percent of the aircraft cost.

Several pitfalls may arise when seeking and maintaining the lessor exemption. If the taxpayer seeking the exemption uses the aircraft for any purpose other than leasing, it cannot elect the lessor exemption. Moreover, if the taxpayer has failed to adhere to the applicable taxing jurisdiction's requirements, the taxpayer may be subject to retroactive payment of sales taxes plus interest and penalties.

Fly Away Exemption

The fly away exemption is also widely used. This exemption is needed when the aircraft is purchased in one state, but will be stored and consumed in another.

For example, the taxpayer resides in Michigan, and he or she intends to purchase an aircraft and then hangar and operate that aircraft out of Michigan. The parties to the aircraft purchase contract may agree that delivery, however, will take place in Illinois. Because the actual closing occurs in Illinois, the state of Illinois will expect sales tax to be paid. Unless, of course, the taxpayer properly elects an exemption.

This is where the fly away exemption comes in. Many (not all) states have provisions that indicate if a taxpayer purchases the aircraft in the jurisdiction and then removes the aircraft within a proscribed period of time allowed under state law, and executes a specific form of exemption certificate, then the purchase of the aircraft is exempt from that states sales tax. In our example, the Illinois fly away exemption applies. To qualify for the exemption, the aircraft either must leave Illinois within fifteen (15) days of the later of the issuance of the final billing for the sale or authorized approval for return of the aircraft for service, maintenance, and testing. The aircraft may not be based or registered in the state of Illinois after the sale. For purposes of this requirements, "based in Illinois" means hangared, stored or otherwise used in the state for more than 10 days in each 12-month period following the date of the sale of the aircraft.

The seller also must retain and provide to the Illinois Department of Revenue a signed and dated certification from purchaser, showing the purchaser has satisfied these requirements. If the taxpayer timely satisfies these requirements, then the purchase of the aircraft is exempt from Illinois tax. It is important to note, however, that the taxpayer also will still be subject to Michigan sales tax.

Not all states have fly away exemption provisions. For example, Hawaii, Ohio, Pennsylvania, and South Carolina do not have a fly away exemption. Note: South Carolina is still a favored destination for closings, because it caps sales tax for the purchase of an aircraft at $500. Similarly, some states, including Delaware, New York and Oregon, do not require a fly away exemption because the state does not charge sales tax on the purchase of an aircraft.

On a final note, this article is not intended to be all-inclusive. Thus, it is critical to confer with a tax professional or attorney who has experience with the specific state(s) in which you are purchasing, storing, and operating your aircraft.

To obtain more information regarding aircraft-related state tax treatments and exemptions, please contact the Barnes & Thornburg attorney with whom you work, or Todd A. Dixon at 616-742-3959 or todd.dixon@btlaw.com.