States Become More Aggressive in Assessing Sales Tax Against Business Aircraft Owners

By Payson Peabody, Galland, Kharasch, Greenberg, Fellman & Swirsky, PC

A recent ruling in New York and actions by the departments of revenue in states such as New Jersey and Virginia illustrate that states have intensified their efforts to raise revenue from taxes on the sale of business aircraft. Revenue department officials have been recording aircraft tail numbers at local airports and sending questionnaires to owners or airport facilities managers to determine whether the owners have paid sales tax and sometimes income tax as well. In the past, it was enough to demonstrate that the aircraft was based or hangared in another state to avoid tax liability. Today, however, the law is far less certain, and state courts and state officials have been unsympathetic to the claims of aircraft owners. Congressional action may be the only way to restore predictability to this area of law.

In New York, earlier this year, a Cessna 177 hangared in New Jersey was found to be taxable in New York State at the moment that it landed at one New York airport and took off for another. Due to a single flight within New York state, the Cessna 177, used three fourths of the time outside New York, was found taxable to the full extent of its value. The administrative law judge who decided the case justified the decision by comparing it to cases involving aircraft spare parts installed at New York airports. Both the installation of the spare parts and the flight from one New York airport to another were a kind of exercise of control over the property within the State. This "use" of the aircraft created, in the law judge's mind, a connection to the State of New York sufficient to allow the State to impose a 4 percent tax on a sale that occurred several months earlier in another state.

In an illustration of how unpredictable state sales tax rulings can be, however, New York ruled in favor of a New York-based fractional aircraft owner one month before it decided the Cessna case. The State found that the fractional owner would not be subject to New York sales tax – regardless of how often the fractionally owned aircraft landed in New York – because the owner would not have "dominion and control" of the aircraft under the fractional ownership agreement. In contrast to the Federal Aviation Administration's view of fractional ownership, the New York tax agency found that the fractional share owner was not the true operator of the aircraft. The taxpayer had purchased a "transportation service." Because services are generally exempt in New York, no sales tax was due.

This rare opinion in favor of an aircraft owner is bucking the trend in other states, however, where tax officials have a tendency to give more weight to the business contacts of the aircraft's owner than the actual use of the aircraft. In an Illinois case, for example, a fleet of aircraft that were used in Missouri for several months before entering Illinois were subject to Illinois sales tax, in part, because the owner had its world headquarters in Illinois.

In Virginia, the Department of Revenue has raised an issue about how it will apply its 60-day aircraft registration standard, which triggers the 2 percent aircraft sales tax. First, the State issued guidance in which it counted an overnight stop as two days. More recently, tax officials have indicated that the 60-day test may not require physical presence in the state at all. According to this interpretation, an aircraft owner can become subject to the sales tax by hiring a management company that has made local arrangements to store the aircraft while it is in the State. Even if the aircraft is not present for 60 days, the owner may be subject to tax if the management company has an agreement for hangar space in place with a local fixed base operator and 60 days have elapsed.

Finally, as reported elsewhere, states such as New Jersey, Kentucky and Nevada have been sending questionnaires to charter operators who make use of various airports as a destination for charter flights. In addition to assessing income tax against the charter

operators, it seems likely that tax officials will use the information gathered from its audits to contact the owners of the aircraft used in charter to further determine whether the owners have paid state sales tax.

These developments at the state level can be traced to an erosion of once clear standards in the U.S. Supreme Court about the right of states to tax all kinds of transportation equipment. It was once clear that property in transit was exempt from state tax, because such a tax would amount to a tax on interstate commerce. Interpreting the Commerce Clause, the Supreme Court found the states could not tax interstate commerce directly, and they could not tax commerce indirectly by taxing boats, trains, or trucks instead.

Lately, however, the Court has adopted a more permissive attitude. According to some scholars, with whom the author disagrees, the Court now allows almost any tax on transportation equipment as long as there is no double tax. Capitalizing on this trend, state tax officials have argued, successfully, that there is no harm in an unapportioned tax on 100 percent of the value of an aircraft if the aircraft has not already been taxed in another state. Of course, this ignores the possibility that the aircraft may have been subject to tax in a state where there was no tax or where the aircraft owner paid a low tax. The no double-tax theory of state taxation encourages states with minimal business aircraft presence – because of a high tax, for example – to seek a windfall at aircraft owners' expense.

What's the answer? With the Supreme Court showing little enthusiasm for the old doctrine that protected aircraft, the only solution – other than good tax planning by an aviation tax advisor who knows the rules – would be an appeal to Congress. Congress can, and should, mandate that States have no jurisdiction to tax aircraft sales, when the aircraft is not hangared in the state and is only used to drop off or pick up passengers, or for maintenance, or for temporary storage as part of continuous round-trip travel. Only then can aircraft owners be sure they will not receive an unexpectedly large tax bill, a few years in the future, for a flight you may be planning today.

Payson Peabody is an attorney with the Washington DC-based law firm of Galland, Kharasch, Greenberg, Fellman & Swirsky, PC. His practice focuses on tax matters relating to corporate aircraft.