Navigating the State Tax Minefield:
A Planning Guide for the Small Flight Department

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The men and women who operate the nation's small flight departments are among the busiest business people in the world. You buy, sell, lease, manage and maintain aircraft, hangar space, office space, equipment and supplies. You hold property, licenses and permits. You employ personnel and contractors and provide goods and services. You form and operate companies. You incur expenses, collect revenue and assist your bosses in running their businesses. For a single flight department these activities can be numerous, varied, far flung–and all are potentially taxable in one or more states.

State tax planning, even for the small flight department, can be like negotiating a minefield: what you can't see and don't know can hurt you. Many kinds of taxes apply to the typical flight department, and tax rules and regulations are different in every state.

The first step in understanding your tax obligations is to identify the state taxes applicable to your department. The list of state taxes should include sales tax, use tax, registration fees, fuel tax, employment-related taxes and income, franchise and other similar "doing business" taxes in the state or states in which your business or activities have nexus, and property taxes in the states in which your property has situs.

Sales Tax

Sales tax is a tax on gross receipts from the sale of tangible personal property and certain services by the state in which the sale of such property or services occurs. Usually, the sales tax is paid by the purchasers and collected by the sellers. Some states such as Arizona impose a transaction privilege tax directly on sellers.[1]

Sales tax may apply to purchases by a business of everything from cleaning services to motor vehicles, but for a flight department the biggest impact occurs when sales tax or use applies to its aircraft and related services and equipment. A flight department may also be required to collect sales tax when it sells or leases aircraft, parts, equipment, or provides services.

Alaska (except for certain local taxes), Montana, New Hampshire and Oregon do not have general sales tax. Delaware does not have a general sales tax but does have retailers', wholesalers' and lease taxes.[2] Connecticut does not impose sales tax on aircraft weighing more than 6,000 pounds.[3] Oklahoma imposes an aviation excise tax on transfer of aircraft ownership in lieu of any applicable sales tax.[4] South Carolina limits aircraft sales tax to a maximum of $300; in North Carolina the tax limit is $1,500 on the sale of an aircraft.

Several other states have sales tax exemptions applicable to aircraft sales. Some of the common sales tax exemptions include the common carrier exemption, non-resident (or "fly away") exemption, sale for resale exemption, and the casual or isolated sale exemption. A number of states provide for a trade-in credit, which reduces the tax base to the difference between the values of the traded and acquired aircraft.

It is important to understand the criteria for qualifying for an exemption or credit in a particular state. The criteria differ greatly for the same category of exemption in different states. For example, both New York and

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[1] Ariz. Admin. Code §R15-5-2210A.
[2] Del. Code Ann. tit. 30 §§2902, 2905, and 4302.
[3] Conn. Gen. Stat. §12-412(99).
[4] Okla. Stat. Ann. tit. 68 §6002.

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Arizona have common carrier exemptions, but in New York the exemption[5] may apply to an FAR Part 91 operator providing related company transportation, whereas in Arizona the carrier must have a U.S. Department of Transportation Certificate of Public Convenience and Necessity.[6] Other states require the aircraft to be used in FAR Part 121 operations. Exemptions and credits are strictly construed, and the burden of qualification is on the party claiming the exemption. Most states impose penalties for non-compliance.

Many states also impose a tax on the sale of aircraft parts and services such as modification, refurbishment and repair. However, some exemptions exist for the sale of such parts and services. For example, Florida exempts the sale of replacement engines, parts and equipment used in the repair or maintenance of aircraft of more than 15,000 pounds maximum certified takeoff weight being repaired or maintained in Florida, and the labor charges for the repair and maintenance of aircraft with more than 15,000 pounds maximum certified takeoff weight, from Florida sales and use tax .[7]

In many states, if labor related to aircraft repairs and maintenance is invoiced separately from the sale of parts, it is exempt from sale tax. Keep in mind that it is important to pay attention to each state's specific qualifications for these exemptions.

Use Tax

Use tax is a tax on the use, storage and consumption of tangible personal property in a state. The tax is generally based on the value of the property used, stored, or consumed. Use can be broadly defined to include the exercise of a right or power over tangible personal property incident to the ownership or possession of that property and the direct or indirect benefit from a taxable service. Use tax is typically imposed directly on the consumer by the state. However, vendors with sufficient nexus to a state may be required to collect that state's use tax.

Use tax generally complements sales tax. Every state with general sales tax also has use tax. In most cases, if a consumer has not paid sales tax on the purchase of an item, the item will be subject to use tax unless an exemption applies.

Use tax may be imposed on a variety of business activities. However, a flight department is particularly concerned with use tax on big-dollar items such as its aircraft and related equipment.

Various states have different ways of determining when to trigger the use tax. Some states, such as California and Michigan, presume that an aircraft is purchased for use in the state and thus subject to use tax in that state, if the aircraft is brought into the state for use within a certain period from the date of purchase.[8] Other states, such as Missouri, provide that any storage, use, or consumption of personal property in Missouri (that is not subject to Missouri sales tax) is subject to the use tax in Missouri, but there are exceptions for temporary use or storage for resale or shipment outside of the state.[9]

If you paid sales tax on the purchase of the aircraft in the state where the aircraft was sold and owe use tax in another state where the aircraft is domiciled, most states will credit the sales tax paid. If the use tax rate is higher than the sales tax rate, most likely you will have to pay the difference in the state in which the use tax is imposed.

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[5] N.Y. Tax Law §1115(21).
[6] Ariz. Rev. Stat. Ann. §42-5061(B)(7).
[7] Fla. Stat. Ann. §212.08(7)(ee) and (tt).
[8] Cal. Code Regs. tit.18 §1620 (3) and (4) and Mich. Comp. Laws Ann. §205.93(1).
[9] Revised Statutes of Missouri §§144.610 and 144.605.

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Taxes on Leases

Leases are typically taxable as sales. In many states, the purchase of property for lease is a purchase for resale and, with the proper steps and documentation, exempt from sales tax. The lessor is then required to collect and remit the tax (either sales or use tax depending on the state and the circumstances) from the lessee at the time each lease payment is made.

In some states such as New Jersey, however, the lessor must pay the sales tax at the inception of the lease on the total purchase price of the aircraft or on the total amount of lease payments for the term of the lease.[10] Other states such as Illinois consider the lessor to be the user of the aircraft and require the lessor to pay use tax on the value of the aircraft.[11] Some states differentiate between types of leases and in such cases true leases, conditional sales, mobile transportation equipment leases, subleases, or rentals may be taxed differently.

In certain circumstances, a change of location of a flight department can lead to double taxation on an aircraft lease. For example, if the lessee of an aircraft moves from New Jersey, where sales or use tax was paid up front on the lease, to Vermont, which taxes lease payments as they are made, the department will be required to begin remitting tax to Vermont without receiving a credit for taxes already paid for the same period in New Jersey.[12]

Registration Fees

Most states have motor vehicle registration fees, but several states, such as New Hampshire and Oregon, also impose aircraft registration requirements and fees for resident aircraft owners and owners locating their aircraft in the state for more than a certain period of time.[13] Some states impose a flat annual aircraft registration fee and other states apply a formula to determine the fee based on factors including value, weight, age, and aircraft type. In many cases the aircraft registration fee is imposed in lieu of personal property tax on aircraft. But beware of states such as Virginia that impose both a registration fee and property tax on aircraft.[14]

Many states that have aircraft registration requirements also require registration and payment of a fee by pilots who are resident in or regularly operating within the state.

Fuel Taxes

Most states also collect taxes on gasoline and aircraft fuel. Typically, such taxes are paid at the pump. Tax rates vary widely from state to state and may be different for gasoline, avgas and jet fuel. Some states offer exemptions or refunds of fuel taxes under certain circumstances. Many states dedicate a portion of aviation fuel tax revenue to a state aviation fund.

Employment-Related Taxes

Most states require employers to withhold state personal income taxes from wages and salaries earned by employees. States may also impose unemployment insurance taxes and other payroll and related taxes on employers. It is important to determine whether your company's contacts with a particular state are sufficient to impose such obligations. It is also important to determine whether the people who work for you are employees or independent contractors under applicable state law.

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[10] N.J. Stat. Ann. §54:32B-2(bb).
[11] Ill. Admin. Code tit. 86 §150.305(e).
[12] Vt. Dept. of Taxes Ruling 2000-01.
[13] N.H. Rev. Stat. Ann. §422:37 and Or. Rev. Stat. §§ 837.015 and 837.045.
[14] Va. Code Ann. §§5.1-5 and 58.1-3500.

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“Doing Business” Taxes
Incorporating, organizing, locating, or doing business in a state may subject the company to that state’s capital stock tax, franchise tax, income tax, and other similar so-called “doing business” taxes. Organizing in a state, income derived from business activities within a state, and property located within a state may subject a company to these kinds of taxes. The tax treatment depends on the type of organization, and the rates vary from state to state. The level of activity in a state necessary to subject a company to a “doing business” tax depends on tax nexus as discussed below. A company conducting business in more than one state generally receives credit for income taxes paid to another such state.

Nexus
You may think your state tax planning is complete once you have investigated taxes in the state in which the company is physically located and your aircraft is delivered, based, and primarily operated. Maybe, maybe not. You may be subject to taxes in other states as a result of nexus. Nexus is the link created by activities in a state by a person or entity that permits the state to impose its taxes on the person or entity.

Determining nexus is a two-part process. First, a business should examine the law of the state involved to determine whether the language of the statutes and regulations includes the business activities at issue. Second, the law and its application must meet constitutional standards.

The test under the Commerce Clause of the United States Constitution is set forth by the U.S. Supreme Court in Complete Auto Transit v. Brady[15] and in subsequent cases. The right of a state to tax interstate commerce is limited to meeting the Supreme Court’s four-part constitutional test: 1) the tax must be applied to an activity having substantial nexus with the taxing state; 2) the tax must be fairly apportioned; 3) the tax must not discriminate against interstate commerce; and 4) the tax must be fairly related to services provided by the taxing state. Generally, to satisfy both Due Process and Commerce Clause concerns, there must be more than minimal physical presence in a state to create nexus for sales and use-tax purposes.[16] It is not clear whether physical presence is necessary for other kinds of state taxes.

States often look at the place of business, presence of property, and employees and other contacts as evidence of nexus for imposing taxes such as sales and use tax and income and other “doing business” taxes.

Nexus of aircraft for use-tax purposes is of particular concern to flight departments because sales tax is relatively easy to avoid, the amount of potential use tax is substantial, and aircraft operate in a number of use-tax jurisdictions. For planning purposes it is important to consider all states in which the aircraft regularly operates, especially where the company has other contacts. For example, in Superior Aircraft Leasing Co. v. Director of Revenue, the Missouri Supreme Court found substantial nexus for the imposition of use tax on the use of an aircraft in Missouri owned by a Missouri corporation with a business office in Missouri where 17.7 percent of total flight hours were logged on flights to Missouri for corporate business.[17] The airplane was purchased in Kansas, based in Ohio, and operated primarily outside of Missouri; however, the ownership of the aircraft by a Missouri corporation with a business office in Missouri and the flights to Missouri was found to be sufficient nexus for Missouri use tax.

Property Taxes
Many states impose an annual tax on the value of real property and personal property located within the state. Real property tax may apply to a flight department’s hangar and office space. Personal property tax may

[15] 430 U.S. 274 (1977).
[16] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).
[17] 734 S.W.2d 504 (Mo. banc 1987).

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apply to all other tangible items. A flight department's most valuable tangible personal property probably is its aircraft.

Many states impose personal property tax on aircraft. Such a tax is often administered by the counties and the rates may vary between airports within a particular state. Whether such a tax applies in a certain jurisdiction may depend on factors such as location of the aircraft on the assessment date, and habitual or periodic location of the aircraft. As with other state taxes, exemptions and credits from property tax differ greatly between the states. Kansas exempts aircraft used in business from property tax,[18] but other states exempt aircraft used for personal purposes from property tax. Some states, such as Texas, consider the ratio of aircraft departures from within the state to departures from outside of the state to determine the property tax assessment when property tax is imposed.[19]

Situs

The privilege of a state to tax property depends on the situs, or the legally determined location, of the property. Continuous physical presence in a particular location is not required for taxable situs. Generally, the domiciliary state may impose property tax but property may also acquire taxable situs in another state.

Every state with property tax designates an assessment date to determine the presence of taxable property in the state and the calculation of taxable value. For migratory property such as aircraft, periodic or habitual location of the aircraft in the state may create situs even if the aircraft is not at that location on the assessment date. States apportion property tax on migratory property based on situs.

Conclusion

Managers of small flight departments should be aware of state taxes applicable to their operations. This article provides a general overview of such taxes, but be aware that there are also county, city, municipal and other miscellaneous taxes that should be considered. You can learn more about state taxes on aviation activities from the National Business Aviation Association Web site at **www.nbaa.org/taxes**. In addition, most state departments of revenue and tax commissions maintain a Web site with information, publications, and contact numbers for assistance with state tax questions. Our Web page, www.coolinglaw.com, provides links to many of these sites. Finally, your tax advisors should be able to provide guidance with state tax planning. Above all, watch your step – careful planning is the best way to avoid a surprise state tax assessment.

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[18] Kan. Stat. Ann. §79-201k.
[19] Tex. Code Ann. §21.055.

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