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SALES & USE TAX UPDATE California, Indiana and Florida

Recent actions by the Indiana and California Legislatures may impact aircraft buyers in these states. We also have an update on the Florida Department of Revenue attempting to tax non-Florida based aircraft.

CALIFORNIA

On August 24, 2007, Governor Arnold Schwarzenegger signed into law the 2007 to 2008 California State Budget. The budget does not include an extension of California Revenue & Taxation Code Section 6248, which expired on June 30, 2007. Instead, the "90 Day Test" that existed on October 1, 2005 is reinstated as of July 1, 2007.

Unless a trailer bill is passed to extend the statute that existed on June 30, 2007, any aircraft purchase closing on or after July 1, 2007 will be eligible for sales and use tax exemption under the old rule which requires that the aircraft be delivered outside of California, be first functionally used outside California, and be kept outside California for ninety days.

It is possible that such trailer legislation may be made retroactive to July 1, 2007. However, it is not a likely scenario at this juncture, according to sources that we spoke with. The interstate commerce sales and use tax exemption continues to be available to aircraft owners who use their aircraft for business use outside California and allows the owners to utilize the aircraft in California immediately after purchase.

INDIANA

Like many other states, Indiana has a statutory rental and leasing exemption that exempts the purchase of equipment from sales and use tax provided that the equipment is used exclusively for rental and leasing. Historically, this exemption has applied to leased equipment, such as trucks, automobiles and copiers, as well as to aircraft.

For the past few years, Indiana Department of Revenue has administratively denied this exemption to aircraft purchasers, claiming that a Part 91 operator is not allowed by the Federal Aviation Administration to rent or lease an aircraft. Many Indiana taxpayers have appealed these rulings and these cases are scheduled to be heard by the Indiana Tax Court in the near future.

In the last session of the Indiana legislature, a bill was passed that targeted aircraft owners exclusively. The following is the language of the bill:

(e) This subsection applies only after June 30, 2008. A transaction in which a person acquires an aircraft for rental or leasing in the ordinary course of the person's business is not exempt from the state gross retail tax unless the person establishes, under guidelines adopted by the department in the manner provided in IC 4-22-2-37.1 for the adoption of emergency rules,

that the annual amount of the lease revenue derived from leasing the aircraft is equal to or greater than:

- (1) ten percent (10%) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was less than one million dollars (\$1,000,000); or
- (2) Seven and five-tenths percent (7.5%) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was at least one million dollars (\$1,000,000).

There is no corresponding legislation that targets companies that routinely rent and lease trucks or other equipment in their businesses. The legislation appears to appeal to the sentiment that aircraft are toys for the super wealthy and not essential business tools for many businesses across America.

FLORIDA

Recently, one of our clients received a letter of inquiry from the Florida Department of Revenue because his aircraft traveled to Florida on three occasions within a six month period after purchase. This client has customers located in the state of Florida but it has no other physical presence in the state. Unless the taxpayer can furnish proof that sales tax has been paid to his home state, Florida will attempt to collect use tax on the aircraft since it entered Florida within six months after the aircraft was purchased.

We do not believe Florida will prevail in a court of law. However, the expense and time involved to win a decision in court may not be justifiable.

OBSERVATION

While the news out of California is very encouraging, we see that as an exception. Clearly, the trend across the country is the continuing increase of enforcement by state agencies to assess sales and use tax on aircraft owners. We discourage aircraft owners from playing the “hide and seek game” – for instance, setting up a Delaware limited liability company and hope that the aircraft will not be located by the home state authority. Timely and sound planning continue to be the best defense against the various state taxing authorities.

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